

Investment Perspectives

Our Current Thoughts on Financials

The recent failures of Silicon Valley Bank and Signature Bank, as well as the takeover of Credit Suisse, have driven broad stock price declines and a weakening in credit spreads for Financials globally. In this paper, we share our thinking on recent developments, our assessment of risks and opportunities, and an update on how we are managing our investment strategies in this environment.

Our Perspective on U.S. Regional Banks and Credit Suisse

The recent deposit runs in the United States were isolated to a few regional banks not held in the Funds. These institutions had an unusual combination of concentrated deposit bases, large balances of uninsured deposits, and unrealised losses from investments and loans. They are not emblematic of the broader U.S. banking system or the Dodge & Cox Worldwide Funds' portfolio holdings. Federal Reserve data shows only modest declines in system-wide deposits since Silicon Valley Bank's failure on 10 March.

Public commentary has focused on the negative impact on the capitalisation of U.S. banks when marking to market their longer-duration¹ securities portfolios. However, this overlooks two important factors. Most banks have stable funding sources, and the securities they hold are largely government-backed issuances, like U.S. Treasuries, that will eventually pay off at par. Further, the Fed's Bank Term Funding Program² (BTFP), which was created on 12 March, makes it unlikely a bank would need to realise losses by selling securities to meet deposit redemptions. In our view, the impact of fair value declines of longer-duration security holdings is more of a transitory earnings issue than a solvency concern.

In Europe, Credit Suisse dominated the headlines in mid-March and led to a loss of market confidence, which ultimately resulted in UBS Group acquiring Credit Suisse to restore confidence in the stability of the Swiss economy and banking system. Credit Suisse's issues were isolated and started well before the U.S. regional banks came under pressure. The Global Stock Fund held a 0.4% position in Credit Suisse at year end, which we sold during the quarter. As of 31 March 2023, the Funds did not hold any securities issued by Credit Suisse.³

We hold UBS Group in the Global Stock and Global Bond Funds.⁴ UBS has an attractive mix of market-leading, capital-efficient, and geographically diversified businesses. The company has created significant shareholder value in recent years through its high return on invested capital and strong capital allocation. In our view, UBS received favourable deal terms in its merger with Credit Suisse, including a low purchase price, downside protection from the government, unique synergies, and concentrated market share in the Swiss banking business. While the merger introduces new risks (e.g., increased complexity, integration challenges, litigation), we have considered them in our analysis and believe the benefits outweigh the risks.

How We Are Evaluating the Current Environment

We continue to analyse all of the Funds' Financials holdings for signs of stress—especially liquidity/funding, unrealised security losses, and asset quality. As part of our ongoing due diligence, we have met with management at many of these companies since Silicon Valley Bank failed. While there has been general market weakness across Financials, we do not see broader signs of stress among the Funds' holdings.

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Looking forward, we expect to see changes in depositor behaviour, tougher regulatory standards for both capital and liquidity, and potential reductions in credit quality due to tightening financial conditions, particularly within commercial real estate. In addition, we expect increased regulatory focus on banks with less than \$700 billion in assets, where recent stresses were most significant.

Why the Funds Remain Overweight Financials

Current valuations for the Funds' Financials holdings are inexpensive on both an absolute and relative basis. Even after factoring in emerging headwinds into our analysis, we remain more optimistic about the longer-term resilience, earnings capacity, and capital return potential for our holdings than current valuations imply. The Funds' top-10 Financials holdings are listed in the Appendix.

U.S. Holdings

In the United States, the Funds' holdings are primarily concentrated across two types of institutions. The first is global systemically important banks that already comply with tougher regulatory standards than regional banks, and will likely gain deposit share (e.g., Bank of America, Citigroup, JPMorgan, Wells Fargo). The second is financial institutions that operate largely in capital markets and have low credit risk exposures (e.g., Bank of New York Mellon, Charles Schwab, Goldman Sachs).

Importantly, the Funds' U.S. holdings have significantly benefited from rising interest rates. Across our equity Funds' U.S. bank holdings, net interest income was 39% higher year-over-year on average in the fourth quarter of 2022. Our only exposure to U.S. regional banks is Truist Financial, which represents 0.6% in the Stock Fund.⁵

European and UK Holdings

The Funds' European and UK holdings (e.g., Banco Santander, Barclays, BNP Paribas, HSBC) are inexpensive and stand out as particularly attractive when taking into account significant balance sheet improvements, de-risking, and cost cutting over the last decade. Return on equity (ROE) for European banks

approximately doubled from 4% on average in 2010-2016 to 9% over 2021 and 2022, despite the earnings headwinds from declining interest rates. Rising European interest rates should provide a profitability tailwind for these holdings.

Since the Global Financial Crisis, European banks have faced ongoing regulatory tightening. Today, they comply with capital, liquidity, and funding standards that are arguably tougher than their U.S. counterparts. While these measures created a drag on earnings and capital return during the implementation phase, they now provide stability in this period of heightened volatility. European regulators continue to allow banks to pay dividends and buy back shares, which could translate into high single-digit capital return yields across the Funds' holdings.

Emerging Market Holdings

In our equity-focused Fund strategies, our emerging market holdings are focused on strong banking franchises (e.g., Axis Bank, ICICI Bank, Itau Unibanco) in India and Brazil that are domestically funded and less impacted by recent events in the U.S. banking market. Balance sheets for emerging market holdings remain robust. Importantly, these holdings have strong growth characteristics and should benefit from more people gaining access to and utilising their financial services, as well as market-share gains.

In Closing

We continue to actively monitor the Financials sector and make portfolio decisions that incorporate our longer-term view of relative risk/reward across investment opportunities.

Since 1930, Dodge & Cox has navigated many challenging periods. In our experience, patience and persistence through turbulent markets are often rewarded in the long term. We are maintaining our disciplined investment approach—underpinned by our investment team's focus on valuation and extensive knowledge of the securities, issuers, and sectors in which we invest. We remain confident in our ability to navigate this market environment and help our clients meet their long-term financial goals.

Thank you for your continued confidence in Dodge & Cox.

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1. Duration is a measure of a bond's (or a bond portfolio's) price sensitivity to changes in interest rate.
 2. The Bank Term Funding Program (BTFP) makes additional funding available to eligible depository institutions to help assure banks have the ability to meet the needs of all their depositors. The BTFP offers loans of up to one year in length to banks, savings associations, credit unions, and other eligible depository institutions pledging any collateral eligible for purchase by the Federal Reserve Banks in open market operations, such as U.S. Treasuries, U.S. agency securities, and U.S. agency mortgage-backed securities. The BTFP is an additional source of liquidity against high-quality securities, eliminating an institution's need to quickly sell those securities in times of stress.
 3. The use of specific examples does not imply that they are more or less attractive investments than the Funds' other holdings. The Funds' portfolio holdings are subject to change without notice. The specific securities mentioned do not represent a Fund's entire holdings. The mention of specific securities is not a recommendation to buy, sell, or hold any particular security and is not indicative of Dodge & Cox's current or future trading activity.
 4. On 31 March 2023, UBS Group was held in the Dodge & Cox Worldwide Funds—Global Stock Fund (2.1% position) and Global Bond Fund (0.4% position).
 5. Unless otherwise specified, all weightings and characteristics are as of 31 March 2023.

Appendix

The Dodge & Cox Worldwide Funds' Top-10 Financials Holdings (as of 31 March 2023)

Global Stock Fund	% of Total Fund
Banco Santander SA (Spain)	2.4%
UBS Group AG (Switzerland)	2.1%
BNP Paribas SA (France)	2.0%
Standard Chartered PLC (United Kingdom)	1.8%
Fiserv, Inc.	1.7%
Charles Schwab Corp.	1.6%
Axis Bank, Ltd. (India)	1.6%
Bank of New York Mellon Corp.	1.6%
Barclays PLC (United Kingdom)	1.5%
Wells Fargo & Co.	1.3%
Other Financials Holdings	8.9%
Total Financials	26.5%

U.S. Stock Fund	% of Total Fund
Wells Fargo & Co.	3.4%
Charles Schwab Corp.	3.3%
Fiserv, Inc.	3.0%
MetLife, Inc.	2.8%
Capital One Financial Corp.	2.7%
Bank of New York Mellon Corp.	2.1%
Goldman Sachs Group, Inc.	1.6%
State Street Corp.	1.5%
Fidelity National Information Services, Inc.	1.1%
Bank of America Corp.	0.9%
Other Financials Holdings	1.0%
Total Financials	23.3%

Emerging Markets Stock Fund	% of Total Fund
ICICI Bank, Ltd. (India)	2.8%
Itau Unibanco Holding SA (Brazil)	2.7%
Axis Bank, Ltd. (India)	2.6%
Credicorp, Ltd. (Peru)	1.6%
Prudential PLC (Hong Kong)	1.5%
XP, Inc. (Brazil)	0.8%
Ping An Insurance (Group) Co. of China Ltd. (China)	0.5%
Shinhan Financial Group Co., Ltd. (South Korea)	0.5%
Vietnam Technological & Commercial Joint Stock Bank (Vietnam)	0.4%
Military Commercial Joint Stock Bank (Vietnam)	0.4%
Other Financials Holdings	7.9%
Total Financials	21.7%

Global Bond Fund	% of Total Fund
JPMorgan Chase & Co.	1.8%
HSBC Holdings PLC (United Kingdom)	1.7%
Bank of America Corp.	1.5%
BNP Paribas SA (France)	1.4%
UniCredit SPA (Italy)	1.2%
Citigroup, Inc.	1.0%
Barclays PLC (United Kingdom)	1.0%
Wells Fargo & Co.	1.0%
Navient Corp	0.9%
NatWest Group PLC (United Kingdom)	0.8%
Other Financial Institutions Holdings	2.9%
Total Financial Institutions	15.1%

The Global Stock Fund, U.S. Stock Fund, and Emerging Markets Stock Fund are based on the GICS Financials sector grouping. The Global Bond Fund is based on the Lehman Class 2 Financial Institutions grouping.

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