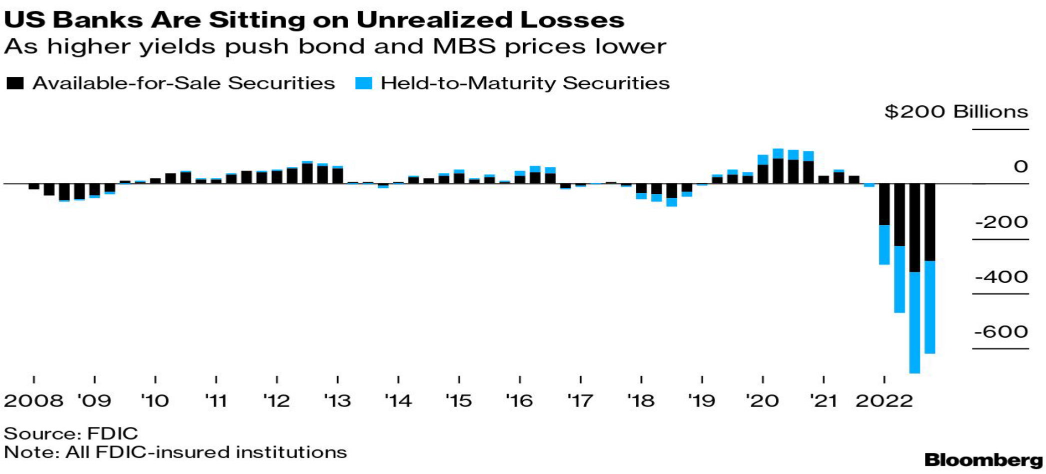
Market Review April 2023

March was a busy month. The arrival of spring of 2023 had a hint of a 'remake' of 2008. However, let us be clear from the outset, there is little to compare it to. Only the birds of ill omen seem to see similarities between the great financial crisis of 2008 and what we are experiencing at the moment! On 8 March, we learned that Silicon Valley Bank (SVB) was in serious financial trouble. The startup's favourite commercial bank was forced to sell a large portfolio of treasury bonds in order to meet customer cash outflows. The problem was that the value of this portfolio was lower than the value recorded in the bank's equity. The securities sold should have been held by the bank until maturity (HTM), which gave the bank the right to value them at par, although as a result of the rise in interest rates, this portfolio had a much lower liquidation value. Other US banks are also sitting on huge amounts of unrealized losses. However, unlike SVB, they do not have to sell them.



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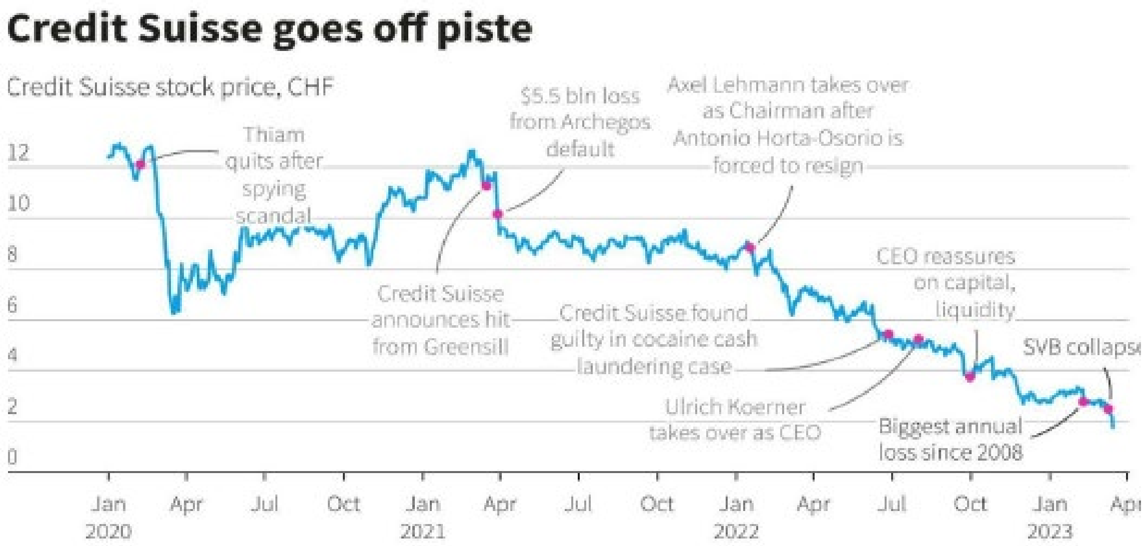
This may have happened for two reasons. The first seems to be the naivety of the SVB's management, which, when buying tons of long-term bonds with its own funds, apparently did not imagine that this

could backfire. The fact that the bank operated for several months without a risk officer is certainly not unrelated to this situation. The second reason seems to date back to 2018 and a certain executive order ratified by President Trump. Under pressure from various commercial banks (including the SVB...), the minimum deposit limit for a bank to undergo drastic controls and be considered "too big to fail" was raised from 50 to 250 billion. As a result of this decision, many banks benefited from lower capital reserve requirements compared to large systemic banks.

A few days after SVB, we learned that the bank Signature was facing the same liquidity problems. A wind of panic blew over the sector. The US banking sub-index collapsed by almost 30% while its European counterpart fell by 11.7%. Central banks reacted quickly by announcing almost unlimited short-term liquidity to guarantee customer deposits. This stopped the haemorrhaging in the sector but not in all banks. Credit Suisse, which was already in the crosshairs of investors, continued to suffer massive outflows. The bank is said to have lost more than 450 billion dollars in deposits in the space of a few days. On the night of 15/16 March, the SNB announced that it would make CHF 50 billion available to the bank to meet its obligations. The Credit Suisse share, which had been in free fall until then (-40% since the beginning of March), rebounded violently in the session that followed, but the joy was short-lived.



Note: March 15, 2023 price as at 1054 GMT
Source: Refinitiv Datastream | Reuters, March 15, 2023 | By Vincent Flasseur

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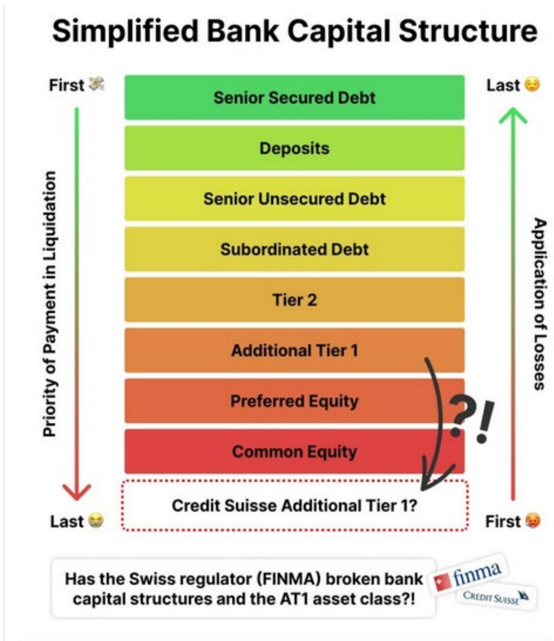
The "awkward" announcement by the Chairman of Saudi National Bank, a recent shareholder who had participated in a capital increase in November 2022 for an amount of 4.2 billion dollars, did not help. The latter (who had to resign a few days later) firmly announced in an interview that the bank was **not** considering recapitalising Credit Suisse at all. Over the following weekend of 18-19 March, we learned that UBS was going to "merge" with its direct competitor, a transaction orchestrated by the Federal Council, the Swiss National Bank and FINMA. The word "merger" was articulated, but there is no doubt that UBS has swallowed its rival. The terms of the deal have been (and still are) much talked about. Senior creditors now benefit from a guarantee from UBS and shareholders will receive CHF 3 billion from the leading Swiss bank (or CHF 0.75 per share, which represents a valuation of around 70% below the last stock market price on Friday 17 March). On the other hand, the holders of AT1 debt (known as Contingent Convertible "CoCo") will not receive a cent, which seems to have raised the eyebrows of the largest central banks. Indeed, according to certain conditions mentioned in the issue prospectuses (we can discuss for hours if these conditions are really fulfilled, but the subject will not be discussed here...), the CoCo bonds can be written off in full in order to avoid a bank failure. This is a "buffer" capital that increases the equity capital. This measure was taken after the financial crisis in order to strengthen confidence. The cumulative amount of these bonds was almost 17 billion Swiss francs! What is very special about this case is that the hierarchy of subordination of liabilities was not respected. Logically, when a company is liquidated, the shareholder receives the result after the liquidation of the assets and the repayment of the debts...in this case, the shareholder will receive a residual value while all the creditors have not been repaid. The Swiss government had to modify a law in emergency during the weekend of 18-19 March to make this "legally possible". In addition to this failure to respect the balance sheet hierarchy, neither UBS nor Credit Suisse shareholders had any say in the deal. These decisions are likely to be challenged in court, although the chances of success appear to be relatively low at present.



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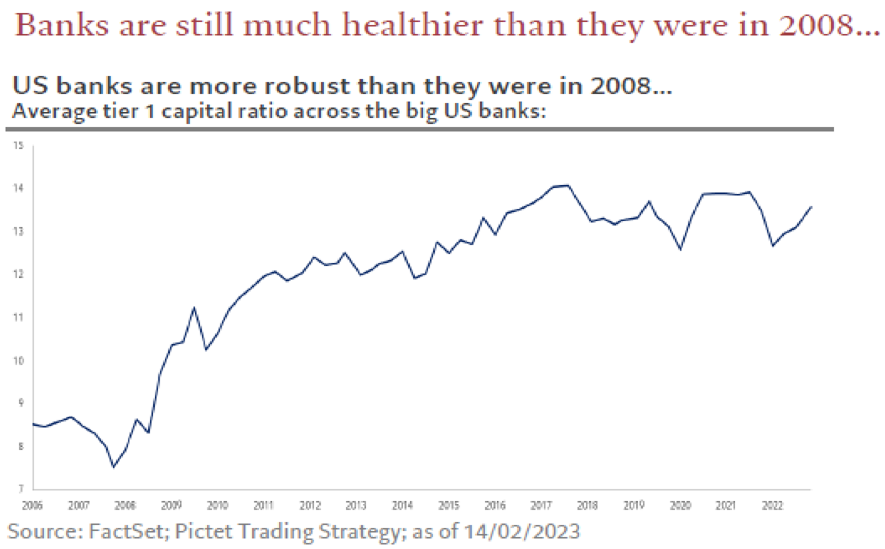
UBS has also obtained guarantees from the Swiss government and the SNB to take on the role of "white knight" and its board of directors has asked Sergio Ermotti to return to head the bank to manage the integration and restructuring of the new group. Ermotti, who was CEO of UBS from 2011 to 2020, knows the bank better than anyone else and had already carried out a risk-reduction mission during his previous tenure, reducing exposure to investment banking and focusing on wealth management activities.

To conclude on this subject, we can be sure that: i) the debates are far from over; ii) this case sets a historical precedent that will leave its mark and probably provoke regulatory and legal changes; iii) UBS seems to have made a good deal by taking over Credit Suisse at a discount on top of all the state guarantees; iv) even if the risk of contagion cannot be excluded (the pressure on Deutsche Bank in the days following the CS takeover is proof of this) the solidity of the banking sector is much higher than in 2008 and the respective central bankers are much more reactive than then, which should channel any panic movements.



This crisis of confidence complicates the task of central banks. In March, the latter applied the expected rate hikes, namely +50 basis points for the ECB and +25 basis points for the FED, to name but two. While Western central banks had been trying to convince the market since the beginning of the year that the fight against inflation was not over and that restrictive monetary policies were necessary, they had no choice but to inject liquidity quickly to try to reassure investors. This seems to have had the desired effect as the bleeding was stopped quickly. The consequences of this crisis of confidence in the banking sector were quickly felt. Investors drastically lowered their forecasts for the FED's key interest rates. The deduction is simple: if banks suffer from a shortage of short-term liquidity, they are less willing to lend to companies that need new money to finance the development of their business. This should therefore have a direct impact on employment and future growth. In the second half of March, many economists raised the probability that the US and Europe will face a recession in the next 12 months.

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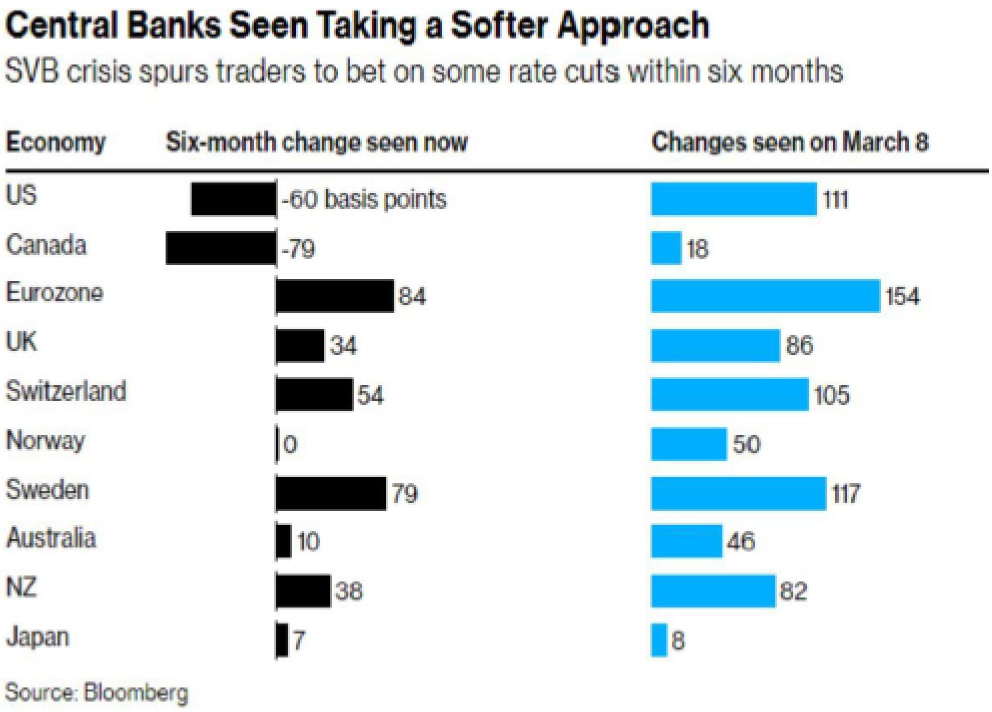

This had a logical impact on interest rates. Short rates fell faster than long rates, reducing the inversion of the curves. In the US, for example, the 2-year yield fell by 68 basis points to 4.12% while the 10-year yield fell by 38 basis points to 3.53%. The inversion of this curve is now only 56 basis points whereas it was around -100 basis points at the beginning of March. In this environment of contracting liquidity, credit spreads have also logically widened. The high-yield segment offers almost a 5% excess yield over a government bond.

High Yield CDS EU and US

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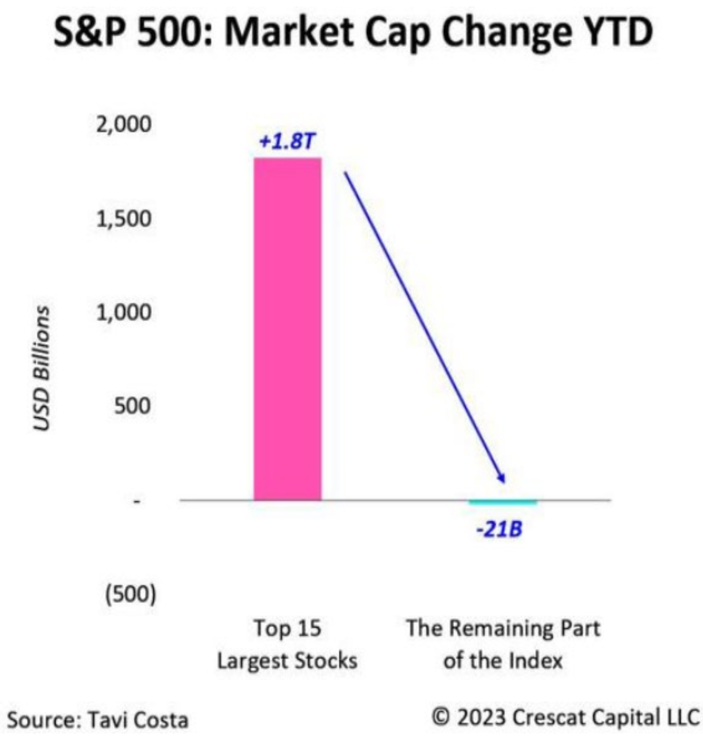
The equity indices did not fare too badly despite the general slump. The banking sub-index was logically among the worst performers of the month. Defensive sectors such as food and utilities held up well, while technology continued to outperform strongly. The Nasdaq gained 9.46% in March, bringing its year-to-date gains to over 20%. To date, the index has recovered more than 40% of its decline between late 2021 and October 2022. The S&P500 also rose by 2% in March and has a year-to-date performance of 7%. It should be noted that this performance was driven by 15 stocks including Apple, Amazon, Nvidia and Alphabet to name a few. After a depressed 2022, the big technology companies already seem to be winning back the favour of investors.



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Market developments to the end of March 2023

End of March	MSCI World	S&P 500	EuroStoxx	CAC	Spain	Switzerland	MSCI EM	CSI 300
	Equities in Local Currencies							
Perf 1 Month	2.83%	3.51%	1.81%	0.75%	-1.73%	0.07%	2.73%	-0.46%
Perf 3 Month	7.25%	7.03%	13.74%	13.11%	12.19%	3.51%	3.54%	4.63%
Perf YTD	7.25%	7.03%	13.74%	13.11%	12.19%	3.51%	3.54%	4.63%

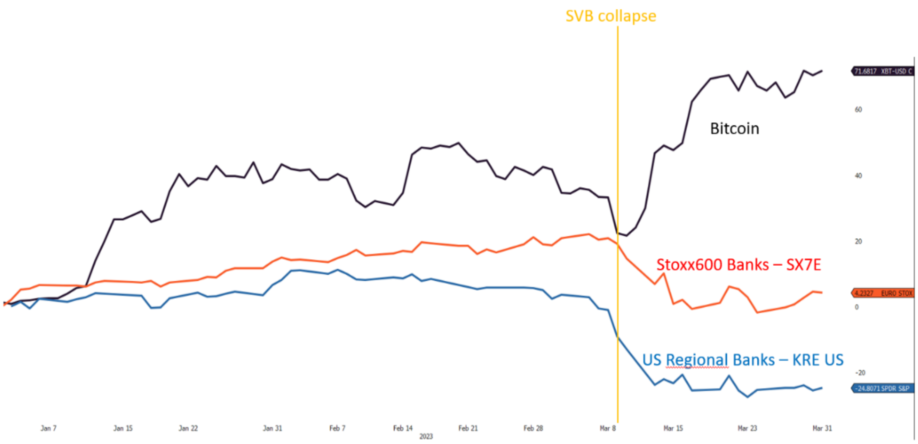
End of March	WTI Oil	Brent Oil	Gold	Copper	USD	JPY	GBP	CHF
	Commodities				Currencies vs EUR			
Perf 1 Month	-1.79%	-4.91%	7.79%	0.36%	-2.43%	-0.07%	0.04%	0.44%
Perf 3 Month	-5.72%	-7.15%	7.96%	7.42%	-1.23%	-2.55%	0.70%	-0.26%
Perf YTD	-5.72%	-7.15%	7.96%	7.42%	-1.23%	-2.55%	0.70%	-0.26%

End of March	Global Aggregate	US Aggregate	Euro Aggregate	US 10 Year Treasury	German 10 Year Bund	Global Credit	Global High Yield	Emerging Sovereign $
	Bloomberg Indices Bonds Total returns							
Perf 1 Month	3.16%	2.54%	2.00%	3.70%	4.37%	2.83%	0.92%	1.24%
Perf 3 Month	3.01%	2.96%	2.09%	3.51%	3.75%	3.33%	3.15%	2.15%
Perf YTD	3.01%	2.96%	2.09%	3.51%	3.75%	3.33%	3.15%	2.15%

Source: Bloomberg 31/03/23.

In this uncertain economic environment, Gold and Silver continued to perform well gaining 7.8% and 15.2% respectively in March while most commodities tended to stagnate. Oil (-1.79%) was even down for the 6th consecutive month on fears that a recession could materialise. OPEC's announcement during the 1st weekend of April to reduce production should give the black gold some colour. After a rebound in February, the Dollar Index fell in March and resumed the negative trend that began in September 2022. The index has lost more than 8% over the last 6 months.

It might sound strange, but the other big winner from this crisis of confidence in the banking system is none other than Bitcoin. Most digital assets have rebounded since the FTX collapse, but Bitcoin, like the FAANGs in the technology sector, has used its visibility to outperform its peers. The chart below speaks for itself. It would appear that some investors continue to see Bitcoin as a serious alternative to the traditional financial system, and rightly so.



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At this stage it is difficult to draw clear conclusions from all the events we have experienced in March. Here is what we can learn from them:

- As we saw with the 2020 lockdown announcements, governments and central banks are increasingly quick to react when a systemic problem arises. This is reassuring, but the downside is that this interventionism encourages risk-taking.
- As a result of the sharp rise in interest rates and the reluctance of banks to lend, credit conditions are likely to tighten. This could cause liquidity problems for some companies that need to refinance. Should we fear a future cascade of bankruptcies among the "zombie" companies?
- Interest rates should stabilise. However, a return to a pre-Covid level (low growth/low inflation) seems difficult to envisage. The paradigm shift seems to have taken place and central banks will continue to walk on eggshells.
- In the past, rate hikes have taken between 9 and 12 months to be felt in the real economy. The FED's first rate hike was in March 2022, while the ECB acted in July 2022. It is therefore too early at this stage to conclude that there is a recession. However, the answer should not be long in coming.
- Equity markets are resilient. Innovative companies with strong balance sheets should take advantage of the current situation to strengthen their position.

We wish you a happy Easter and remain at your disposal for further information on any of the topics discussed.

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