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Newsletter: The Inevitable Credit crunch **April 2023**

Key Take-Aways

- Stock Markets ended the month in a positive territory with SP500 closing above 4,100 despite the beginning of a banking crisis in the US and in Switzerland. FED and ECB hiked as planned.

- A newly expected credit crunch may decrease key macroeconomics figures and revert previous anticipations. Any economic slowdown will change central banks' future interest rates hike policy.

- Bond markets of the financial sector hit by Switzerland's decision to write off all of Credit Suisse AT1 debt instruments ("Coco"). A trading premium on other Swiss issued AT1 expected in the future.

- Attractive entry point in the Euro bond markets due to lower rebound in February compared to the rest of the asset class.

- This is not 2008. Banks are well-capitalized, no "toxic" assets in Bank's balance sheets. Liquidity is the issue.

- New expectations that US rates are close to peak may lead to USD losing its carry advantage. EUR may benefit from ECB being late in tightening its monetary policy.

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Review
Financial crisis or not...

March was marked by the unexpected collapse of Silicon Valley Bank in the US, which highlighted the problems posed by the sudden rise in interest rates at banks. This was enough for the market to turn to Credit Suisse, which saw its Credit Default Swaps soar. Despite the rapid reaction of the authorities, which made huge amounts of liquidity available to the bank, the FINMA, BNS and the Federal Council orchestrated the merger of Credit Suisse with UBS.

The European and US central banks raised key interest rates by 25bps and 50bps respectively.

Inflation continues to fall slowly in the US while it is rising slightly in Europe, leading to an easing in US and EU rates and the DXY.

In the equity markets, the S&P500 rose by 3.67, the Nasdaq Composite by 6.78%, while the Russell 2000 fell by -4.78%.

In Europe, the EuroStoxx50 rose by 2.01%, driven by the CAC 40 (+1.72%) and the DAX (+0.86%). The SMI rose by 1.59%, while the FTSE 100 fell by 2.48%.

In Asia, the Nikkei ended the month up 3.04% and the CSI 300 down 0.45%. In Latin America, the S&P/BMV IPC rose by 2.21% while the Ibovespa fell by -2.91%.

As for the US sectors, Telecom and IT were the big winners with +10.39% and +10.93% respectively while Financials contracted by 9.55%.

On the fixed income side, global indices rose, led by the Bloomberg Global Aggregate Index with +3.16%, the EMBI with +1.40% and the BBG Global High Yield with +0.92%. In Europe, the BBG Euro Aggregate index rose by +2.47%.

The DXY index eased by -2.25%.

Government yields in the developed world all eased, with the US 10-year easing 45bps, the bund easing 36bps and the UK Gilt easing 34bps.

The Bloomberg Commodity Index fell very slightly, ending the month at 105.5.

The VIX remained in its 18-22 range to close at 18.7.

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	4,109	1.45	3.50	3.67	7.48	7.48	17
Nasdaq	12,222	1.74	3.38	6.78	17.05	17.05	23
Russell 2000	1,802	1.93	3.96	-4.78	2.73	2.73	18
Euro Stoxx 50	4,315	0.69	4.46	2.01	14.32	14.32	12
Stoxx 600 EUR	458	0.67	4.16	-0.18	8.58	8.58	12
FTSE 100	7,632	0.15	3.14	-2.48	3.55	3.55	10
SMI	11,106	0.67	4.72	1.59	5.09	5.09	16
NIKKEI 225	28,041	0.93	3.27	3.04	8.45	8.45	15
CSI 300 China	4,051	0.31	0.60	-0.45	4.67	4.67	12
MSCI EM Index	990	0.46	1.93	3.04	3.97	3.97	11

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD	EST P/E
S&P 500	4,109	1.45	3.50	3.67	7.48	7.48	17
UTILITIES	344	0.76	3.08	4.92	-3.24	-3.24	17
ENERGY	635	0.63	6.22	-0.21	-4.71	-4.71	11
TELECOM	192	2.08	1.46	10.39	20.50	20.50	15
CONS STAPLES	780	0.83	2.53	4.23	0.83	0.83	19
REAL ESTATE	235	2.22	5.31	-1.40	1.88	1.88	17
CONS DISCRET	1,164	2.62	5.58	3.12	16.05	16.05	22
MATERIALS	508	1.62	5.01	-1.04	4.29	4.29	16
HEALTH CARE	1,511	1.13	1.77	2.22	-4.31	-4.31	16
INFO TECH	2,639	1.47	3.41	10.93	21.82	21.82	22
FINANCIALS	535	1.16	3.78	-9.55	-5.56	-5.56	12
INDUSTRIALS	857	1.32	4.43	0.66	3.47	3.47	17

Currency % Change	Price	1 day	5 days	MTD	QTD	YTD
DXY	102.506	0.35	-0.59	-2.25	-0.98	-0.98
EUR-USD	1.0839	-0.61	0.73	2.49	1.25	1.25
USD-JPY	132.86	0.12	1.63	-2.43	1.33	1.33
USD-CHF	0.9153	0.23	-0.49	-2.86	-1.00	-1.00
EUR-CHF	0.9922	-0.38	0.23	-0.44	0.26	0.26
GBP-USD	1.2337	-0.40	0.85	2.62	2.10	2.10
EUR-GBP	0.8790	-0.15	-0.08	-0.09	-0.71	-0.71
JP EM FX Index	50.82	-0.10	1.16	1.20	1.85	1.85

10 yr Yield Bps Change	Price	1 day	5 days	MTD	QTD	YTD
US	3.47	-8	9	-45	-41	-41
Germany	2.29	-8	16	-36	-28	-28
UK	3.49	-3	21	-34	-18	-18
SWITZERLAND	1.25	-2	10	-22	-37	-37
Japan	0.35	2	4	-15	-7	-7
US IG Spread	145	-2	-11	6	2	2
US High Yield spread	502	-17	-53	32	-7	-7
EUR High Yield spread	469	1	-54	57	-32	-32

Commodity % Change	Price	1 day	5 days	MTD	QTD	YTD
BBG Commo Index	105.5	1.07	2.41	-0.61	-6.47	-6.47
Gold Spot $/OZ	1969.3	-0.56	-0.45	7.79	7.96	7.96
Crude Oil WTI	75.7	1.75	9.18	-1.79	-5.72	-5.72

Volatility	Price	1 day	5 days	MTD	QTD	YTD
VIX	18.7	-0.32	-3.04	-2.00	-13.71	-2.97

Source: Bloomberg 03/31/2023

Macro & Rates
Bank retrenchment and the inevitable credit crunch

In March, the brutal return of stress in the banking sector has modified rapidly the medium-term outlook of the global economy.

Stress in the banking sector brutally took center stage. After the failure of three regional banks in the US earlier this month, the rescue of Credit Suisse by its rival UBS during a week-end only added further mistrust on the global banking system.

At this stage, it is important to be clear. We believe we are not facing a banking crisis like the one observed in 2008. The Great Financial crisis was due to a systematic leveraging of the global financial system. The situation of the banking industry today is not about insufficient level of capital or toxic positions in their balance sheets. Instead, it is about liquidity. The rise in interest rates has depressed the value of the bank investment portfolios. These are supposed to be held to maturity so at some point, the mark-to market value does not impact capital. Unless, like SVB, you have to sell them.

Obviously, there was a risk of contagion. However, the FDIC, in conjunction with the Fed, TSY, UBS, the SNB and the Swiss Confederation come up quickly with workable solutions to mitigate the contagion risk.

So far, the banking crisis may have been avoided (currently we do not know yet) but we will have to deal with the upcoming credit crunch. There is little doubt that tightening of credit should happen, and that should slow the economy … but by how much and when is the question at this moment.

The fact is that back in end of 2022, credit tightening was already in what's typically consistent with recession. Indeed, in the fourth quarter of last year, the US credit impulse (essentially the second derivative of private-sector borrowing as a percentage of GDP) was down -6% of GDP, suggesting a recession.

So, starting from an already contraction level from last year, the additional upcoming regulatory credit tightening will several impacts on the economy. Firstly, it will substitute for rate hikes. The Federal Reserve may hike another 25bps in May but the probability that it pauses thereafter has substantially increased. Secondly, there is little doubt that the expected credit crunch will be disinflationary which at some point justify that major central banks will switch to a "wait and see" mode. Finally, a credit shortfall will for sure deliver a recession anyway.

The depth and length of the recession will depend of 2 main factors: if there is further contagion in banks or not. Recession involving banking crisis are known to be longer and deeper than recessions in which the banking system is not seriously hit. A pre-emptive and coordinated actions from Central Banks or not.

So far, the macroeconomic data is showing resilience, but it is likely that the macro situation will deteriorate rapidly from now on.

Current macroeconomic figures are still showing an expansion in services and a continued strength in the labor market and Consumer Confidence, especially in the US, rose again in March. However, the recent turmoil in the banking sector and the related and inevitable credit crunch will likely and rapidly deteriorate macro indicators and accelerate the recent disinflation trend. In this context and if correct, we expect major central banks to make a pause in their tightening cycle.

In the mean time, geopolitical risks seem to be on the rise in spite of China's peace plan proposed for the Russia-Ukraine conflict. President Xi's trip to Moscow, Europe and the US. This is the first peace attempt made by a third party to the conflict that open the door to an easing of tensions. A fail would obviously bring back the conflict to center stage in investor minds.

The rate-cut pricing as early as July and the associated Fed pivot is ultimately a function of the poor and uncertain outlook rather than the traditional end of hiking cycle that could suggest a soft lending.

We believe the upcoming outlook is a recipe for greater financial market risk premia particularly the Equity risk premia. In this context, we advocate for a quality bias both in the equity and fixed income asset classes, as wells as for adding to gold as a hedge amidst rising macro and geopolitical risks.

Fixed Income
A rebound after the February trough

In March, fixed income rebounded. A mix of stress in the markets and a sharp downward repricing of terminal Fed funds rates helped the asset class.

The strongest performers were US TIPS, US govies and high-quality USD corporate bonds. European equivalents also rose, but to a lesser extent. Indeed, the risk-free curve in the US saw 2-year yields fall by 100bps while the German Bund-curve saw yields fall by a maximum of 70bps.

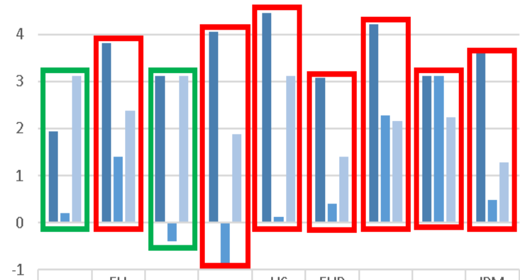
On the contrary, high yield both in USD and EUR remained flattish as spreads widened slightly at relatively elevated levels (500bps in USD and 440bps in EUR). The stress within the banking system (US regional banks and the rescue of Credit Suisse) weighed on the junk part of the market.

In Switzerland, the government decided to wipe out approx. $17bn of Additional Tier 1 (AT1) bonds of Credit Suisse, thereby sending jitters through the whole subordinated debt markets. This decision, which was probably necesseary from a political point of view, will certainly create consequential problems for some time to come. On the last business day before the Credit Suisse rescue, none of the ratio-levels triggering bail-ins had been reached. As a consequence, Swiss AT1 debt from other issuers is now trading at a premium as investors want to be compensated for this additional uncertainty.

US 10-year Treasury yields now seem to be stuck in a range between 3.4% and 4%. Meanwhile, the German 10-year Bund yield, while also seeing strong swings, seems to remain in a clear uptrend, currently trading in the middle of the recent range at 2.3%. As we mentioned before, the more advanced hiking cycle in the US seemed to us favorable for USD bonds, especially on the shorter end.

Now we believe that the smaller rebound in EUR bonds offers an attractive entry-level for high-quality paper in EUR (see table for examples). While the ECB hiked by 50bps in March and kept a hawkish tone, it may soon be in a similar situation like the Fed: seeing terminal rate expectations dialed back in expectation of a cooling economy. The Fed hiked rates by 25bps in March as expected.

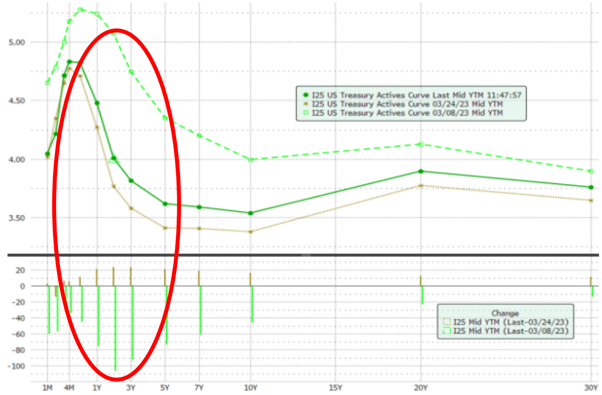
Fixed income performances 19.1.23 & 2.3.23



	US TIPS	EU Linkers	US Gov	EU Gov	US Corp	EUR Corp	US HY	EU HY	JPM EMBI
19.01.2023	1.94	3.81	3.11	4.06	4.45	3.07	4.21	3.11	3.63
02.03.2023	0.21	1.39	-0.4	-1	0.13	0.39	2.28	3.12	0.48
23.03.2023	3.12	2.38	3.11	1.87	3.11	1.4	2.16	2.23	1.28

Source: Bloomberg

US Treasury curves 8.3., 24.3. and 29.3.



Source: Bloomberg

US HY (black) and IG (blue) spreads

Source: Bloomberg

EUR Corporate Bond Opportunities

ISIN	COUPON	ISSUER	MATURITY	IND. PRICE	IND. YIELD	RATING
XS2604697891	3.875	Volkswagen	29.03.2026	100.05	3.86	A3
XS2599731473	3.875	Heineken	23.09.2024	100.82	3.29	BBB+
XS2593105393	3.625	AstraZeneca	03.03.2027	101.74	3.15	A
XS2595410775	3.5	Nestlé	13.12.2027	102.06	3.02	AA-
XS2589712996	4.157	Mizuho Financial	20.05.2028	99.76	4.21	A1
XS2595418323	4	BASF	08.03.2029	102.95	3.44	A
XS2592088236	3.204	Roche	27.08.2029	100.52	3.11	AA

Equity
Banks tumbled. Markets higher.

A new banking crisis avoided ?

Are social networks, which have become preponderant in our daily lives, a starting point of this new banking crisis? Some people think so. One thing is certain, since 2008, central banks and regulators have realized the importance of containing financial crisis as quickly as possible. Silicon Valley Bank's depositors, from individuals to large start-ups that had invested part of their fundraising in the bank, did not have to suffer from the bank's risky investments in long-dated US treasury bonds at a time when interest rates were at their lowest. Both in the US and in Switzerland, radical solutions were set-up over a weekend.

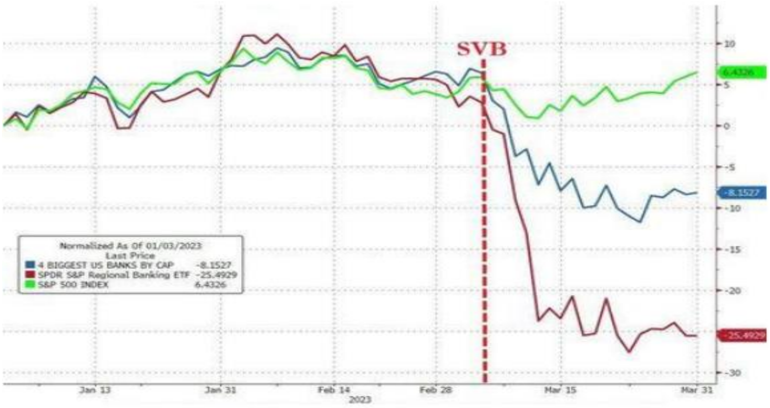
Even if in Switzerland a new trauma similar to the one experienced by the country at the time of the Swissair grounding in 2001 could be avoided, the Swiss have been shocked to witness the slow fall of one of their oldest banks, which had brilliantly gone through the 2008 crisis. Nevertheless, the rescue of Credit Suisse opened a *pandora's* box that worried investors.

For the first time, holders of AT1 subordinated debt, the famous "Coco", took second place to shareholders. Swiss law is different in that respect. It has always been different. Some will say that it is important to read the prospectus and the termsheets carefully; others will say that it is a scandal, since the bank was not technically in a situation of bankruptcy. The price paid to shareholders remain more symbolic than material, since the shareholders received a small fraction of the price at which CS stock was trading two years ago. Nevertheless, this has re-ignited concerns about the entire European banking sector. Who will be next? And what will happen? The Coco market experienced an immediate re-pricing. Rumors made Deutsche Bank tumble on the stock market to the point that the German Chancellor had to intervene immediately in the media to reassure about the situation of the largest German bank.

Nevertheless, one must be reasonable. The situation today is for now very different from 2008, during the global financial crisis. At that time, the major systemic banks faced heavy losses on illiquid securitized assets in their balance sheets in the context of the US real estate crisis. These assets had been sold to the entire international financial sector, which created a contagion effect outside the country. A return of volatility in the sector is fair, as operators are less optimistic about earnings outlooks for banks: a tighten credit market and interest rates that could fall faster than anticipated: both should make us cautious. Playing the sector with capital guaranteed structured products, on the other hand, would bring a nice safety net to those who want to adopt a contrarian approach.

Over the long term, we remain of the opinion that companies with the best governance are those that benefit the most. One of our stock-picking approach based on the theme of "good governance" rightly deserves attention for the G (governance), which in our view remains the key letter. Indeed, a good board of directors that works on the long term by taking into account the interests of its customers, shareholders and employees is more likely to achieve excellent results in terms of E (environment) and S (social).

The S&P 500 is back above pre SVB levels ignoring the bank stocks crisis…



Source: www.zerohedge.com

The increase in volatility allowed us to buy attractive structured products in USD on equity indices. The storm passed quickly and the month of March ended with the S&P 500 back above 4,100 points. A good month overall. At these levels, we remain very cautious on the equity market as the risks of a correction are met. In the US, valuations have become somewhat stretched even though banks could tighten lending conditions and lead to a recession. We expect to see some volatility ahead and buying some protection could help the portfolios.

Forex And Commodities
Will The Fundamentals Put An End To King Dollar?

In March, the US dollar had one of its worst monthly performances since November, with a loss of 3.20% on the dollar index.

The turmoil in the banking sector during March caused investors to reassess their view of future Fed moves, and they are now anticipating U.S. interest rates as close to peaking, which would erode the dollar's carry advantage. Based on this view, the negative trend on the dollar is likely to continue in 2023. Technically speaking, the dollar index confirmed its downside pressure after crossing down the bear flag support (a strong bearish technical indicator) and is now close to reaching its support at the psychological level of 100.

Regarding the EUR/USD, the long-term trend based on these fundamentals should remain in momentum. The differing ECB-Fed monetary policy gives the euro better potential upside against the USD as the pressure remains on the ECB to further tighten its monetary policy.

However, some downside risk for the EUR/USD could remain in place in the near term. Firstly, concerns over the banking crisis' contagion still loom over the global market. If this contagion were to spread over the market, we could see investors seeking refuge in safe havens, and among them, the US dollar should remain the most attractive. Secondly, the EUR became the biggest long position in the G10 Forex market, which pushed the EUR/USD to be overbought. That could lead to general profit-taking with a massive sell-off, affecting the EUR/USD negatively in the short term. Lastly, the market is still remaining on the view that the Fed is winning its battle against inflation. A negative surprise on the next inflation report could indubitably benefit the USD again.

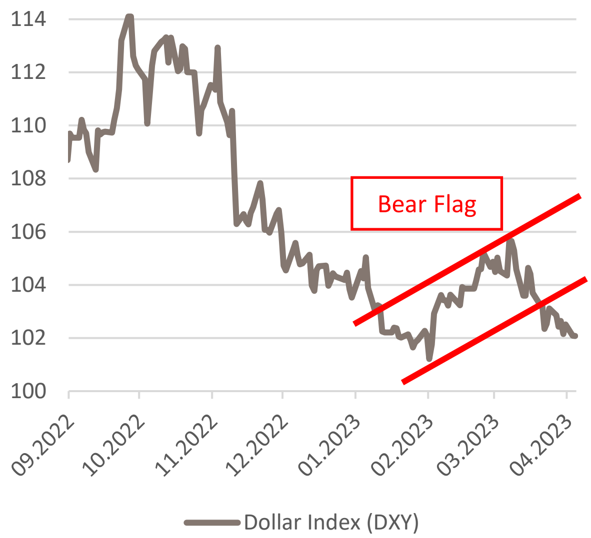
Based on these scenarios, it is likely to see the dollar having some positive pressure in the short term, especially during market stress. Consequently, the dollar may continue to oscillate in the range of 1.05-1.10, with support at 1.07. However, in the long term, the interest rate perspective will definitely give EUR bulls' ammunition that could contribute to a break above the resistance at 1.10, with an end-of-year target of 1.15.

The Swiss franc proved to be very robust despite Credit Suisse's difficulties, confirming its role as a safe haven. The USDCHF tested its new resistance at 0.94 before the negative trend resumed. A break of its previous low at 0.9061 would trigger a decline that could go to the 2021 lowest level at 0.8760.

The other safe haven, the Japanese yen, is still struggling to break its support vs the USD at 130. The BoJ confirmed that an adjustment of its Yield Curve Control (YCC) could be an option if the economy and price condition justify it. Therefore, it rose again investors' hopes for an appreciation of the yen with an end-of-year target below 120.

Gold has stabilized its recent momentum just below the USD 2,000 level and is now trading in the range of USD 1,950-2,000. Stress in the market and a stop in the rate hike from the Fed would push the gold price higher, as gold prices tend to be negatively correlated with US real rates. A break above USD 2,000 could generate higher momentum trend.

Bear Flag Broken on the DXY, More Downward Trend in Perspective ?



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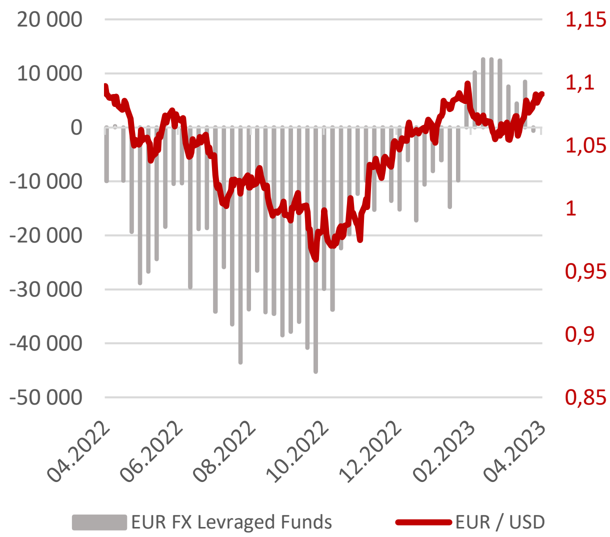
Hedge Funds are Net Long Euro, Overbought Risk on The Short Term ?



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