EDMOND DE ROTHSCHILD

MARKET FLASH: LIQUIDITY, SOLVENCY, CREDIBILITY

• The bank run spread to Signature Bank but the Treasury, Fed and Federal Deposit Insurance Corporation (FIDC) rapidly stepped in to ward off systemic risk, as they guaranteed deposits above the usual level.

• The ECB decided on Thursday to go ahead as planned with a 50bp rate increase.

• At the upcoming FOMC on March 21-22, the Fed will be faced with the same credibility dilemma as the ECB.

At the end of the previous week, SVB Financial Group and Silvergate Capital said they were in serious difficulty. The rapid rise in interest rates meant they had to book losses after being forced to sell bonds to meet massive deposit withdrawals.

The bank run spread to Signature Bank but the Treasury, Fed and Federal Deposit Insurance Corporation (FIDC) rapidly stepped in to ward off systemic risk. They guaranteed deposits above the usual $250,000 level. The Fed also introduced a Bank Term Funding Program to provide liquidity to any other institution confronted with the same problem.

Equity and bond markets nevertheless endured a bout of high volatility. Yields on US and Germany 2-year government bonds plummeted by 60bp and 40bp. The steepening yield curve showed how worried investors were about contagion but also the risk of a more serious recession triggered by the unprecedented pace of rate hikes. The change in the probable growth trajectory is now expected to make central banks revise their monetary tightening programmes in the coming months. The consensus view is that the Fed and ECB will now cut rates by the end of 2023.

At the upcoming FOMC on March 21-22, the Fed will be faced with the same credibility dilemma as the ECB. The ECB decided on Thursday to go ahead as planned with a 50bp rate increase. The bank is focused on today's high inflation which runs counter to price stability. The ECB did, however, stress that current uncertainties would make it cautious on future action but that it would stay data dependent. Chair Christine Lagarde reassured markets that the European banking system was robust and that the ECB had all the fire power needed to deal with any liquidity crisis.

Fears of a major banking crisis receded at the end of the period after 11 of the biggest US banks provided $30bn to save First Republic Bank.

In China, meanwhile, growth continued to rebound gradually. Retail sales rose 3.5% YoY after a 1.8% decline in December, led by basic goods and services (transport, food and shelter).

We are currently focusing on European and US blue chips and protected investments. We still believe that higher interest rates will end up hitting economies and company earnings and that any lulls or rebounds should be used to prepare portfolios for more volatility. The lag between the Fed and ECB monetary cycles has also led us to be more cautious on the dollar and we have increased hedging on US dollar-denominated investments.

EUROPEAN EQUITIES

Trading was extremely volatile as investors weighed two regional bank failures in the US. The entire banking sector was hit, taking highly cyclical companies lower as well, but **Credit Suisse** was the main focus. Saudi Arabia's national bank, the ailing bank's biggest shareholder with 10%, triggered the panic when it said it would not subscribe to any capital raising. Switzerland's central bank had to ensure it would save **Credit Suisse** to avoid contagion. Credit Suisse shares rebounded but cyclicals and banks were still trading well below levels seen 10 days earlier.

Despite hopes that the situation would change the ECB's stance, the bank went ahead with its scheduled 50bp rate increase. Worries may persist on the stability of the banking system but inflation remains a problem: France's inflation was revised higher to 1.1% MoM and +6.3% over 12 months. Thanks to lower energy prices, industrial production in the eurozone rose 0.7% in January, or more than expected, after a 1.1% drop in December.

In company news, **Deutsche Post** is to raise wages by 11.5% to stop an unlimited strike. Volkswagen will be investing more than €180bn in electrification and digitalisation over the next 5 years. Its rival **BMW** sounded a note of optimism for 2023 by claiming it could improve margins without more price rises. **ADP** said airline traffic continued to recover in February but was still running at only 92% of 2019 levels. **Sanofi** paid $2.9bn ($25 a share, or a 273% premium) to acquire **Provention Bio** in the US. The deal will give Sanofi full control of the TZIELD treatment for type 1 diabetes.

US EQUITIES

Banks hogged the limelight over the period with numerous twists and turns both in the US and in Europe. As far as the US is concerned, there were rather reassuring developments to win back some investor confidence in the banking system.

The government and a number of large banks presented a plan to inject $30bn into ailing **First Republic Bank** to reinforce its deposit base. The bank's share price had been down 35% at one point but ended the session 10% higher.

Fed data showed that US banks borrowed a record $164bn from its discount window, a massive increase on the $4.58bn in the previous week. The previous record was $111bn during the 2008 financial crisis.

Risk aversion then abated and Wall Street finished Thursday's session largely in the green. As a result, the S&P 500 and Nasdaq moved back into positive territory, gaining 1.07% and 3.34% over the last 5 trading sessions. Over the last 11 trading days, the Nasdaq outperformed the S&P by a massive 5%.

Sector performance within the S&P 500 was very varied: growth sectors like communication services and IT gained 5.92% and 3.94% while value plays like financials and energy gave up 6.91% and 4.6%.

According to Bloomberg, the chances of a 25bp hike when the Fed next meets on March 21 and 22 are now running at 82% with 18% going for no change. Rates are now seen peaking in May (66% probability of a 25bp rise) with a 50bp cut in January 2024.

In company news, software group **Adobe** jumped 5.9% on a results beat and higher guidance for this year.

President Biden's administration upped the pressure on **TikTok** and asked its Chinese owner **ByteDance** to sell its stake or face a ban in the US. **Meta**, **Snap** and **Pinterest** gained 3.6%, 7.3% and 6%, respectively.

Online payments start-up **Stripe** said it had raised $6.5bn, putting a $50bn valuation on the group. The group was worth $95bn in 2021.

FedEx soared 12% after the bell on better-than-expected quarterly EPS. The group raised its full-year guidance, citing effective cost -cutting.

JAPANESE EQUITIES

The NIKKEI 225 and TOPIX tumbled by 5.63% and 6.47% led by financials stocks following sharp falls on US and European equity markets. Investors fretted over 2 US bank failures and problems at **Credit Suisse**. The stronger yen also affected markets and export stocks like automakers sank.

No sectors gained over the period. Banks, Insurance and Securities & Commodities plunged 15.92%, 13.90% and 11.88%, respectively, as financials bore the brunt of concerns over possible systemic risk.

Nitori, a furniture and interior chain store, gained 3.15% on Yen strength. **Unicharm** (sanitary products) rose 1.66% as investors moved into defensives.

Financials were the worst performers. **Resona**, **Dai-ichi Life** and **Sumitomo Mitsui Trust** tumbled 20.50%, 19.62% and 14.81%, respectively.

The yen jumped from 136 to the high 131s against the dollar on increased expectations the Fed would slow the pace of rate hikes. The Yen is also seen as a safe-haven currency.

On Wednesday, the Japan National Tourism Organisation announced that an estimated 1,475,300 foreigners visited Japan in February, or 88 times more than in the previous year and 56.6% of pre-Covid levels.

EMERGING MARKETS

The MSCI EM Index had lost 1.33% as of Thursday's close. Mexico and Brazil led the decline, down 3.47% and 2.68%, respectively. China (+0.43%) outperformed. India and Taiwan gave up 2.16% and 1.48%, respectively.

In **China**, the PBoC said it would cut the RRR by 25bp after the market close on Friday to emphasise the focus on growth for 2023. Jan-Feb macro data showed the recovery was well underway with retail sales up 3.5%, industrial output 2.4% higher and fixed investment 5.5% better YoY. 55 out of 70 major cities in China saw a rise in new home prices in February while 40 cities saw a rise in existing home prices. Iran and Saudi Arabia agreed in Beijing last Friday to reestablish diplomatic relations and reopen embassies after seven years of tension. President Xi Jinping will visit Russia next week to try and secure a peace pact. In company news, **Ping An Insurance** said the recovery would drive positive NBV growth for both the current quarter and the full year, despite the group missing expectations last year. **Li Ning** issued guidance for revenues to rise by around 15% YoY with net margins also around 15%. Both were slightly below market expectations.

In **Taiwan**, media reports suggested **TSMC** was considering another price hike in the second half of 2023 to meet increasing manufacturing costs.

In **India,** services PMI hit a 12-year high in February, but there were mixed signals in rural activity. India's weighting increased in the EM benchmark in February, leading to inflows of $4.3bn from non-India dedicated passive funds (18% of FII AUM).

In **Brazil**, the regulator unexpectedly lowered the cap allowed for payroll loans on pensioners (INSS). Banks decided to suspend the product after the measure was announced. Results at **Localiza** and **Natura** were lower than expected. Localiza's miss was mainly due to the seminovos business. Management said seminovos had improved performance in Jan/February 2023. **MercadoLibre** is to invest a record $3.6bn (R$19bn versus R$17bn in 2022) in 2023. **Casino** raised $780m from its sale of Assai in Brazil.

In **Mexico,** the local currency lost 4% following the negative news flow on **SVB** and **Credit Suisse**. Mexico's finance minister said the country's financial system was safe: the central bank had not overextended credit and reduced interest rates to close to zero. The National Association of Self-Service Retailers and Department Stores (ANTAD) posted SSS growth of 6.5% for February 2023, marking a sequential deceleration relative to January.

On the supply-chain-relocation front: after winning the AirPod order, Apple supplier **Foxconn** plans another $200m factory in India.

CORPORATE DEBT

CREDIT

In a highly volatile week for government bonds and risk premiums, yields on the 10-year German Bund eventually fell by more than 30bp while they gained 30bp on investment grade, taking premiums to 170-180bp and a 60bp rise in high yield, leaving premiums at 460bp. The Xover jumped from 420 to 500 and the Main from 80 to 100.

Investment grade returns were flat (+0.06%), taking YTD gains to 1.05%. High yield fell 0.73% (1.84% YTD). Actuarial yields for investment grade were 4.2% and 7.0% for high yield, still good entry points for carry strategies. Note that government bond yields currently offset credit risk premiums

Premiums on Euro CoCos widened by a significant 500bp to1,250bp (as of the first call date). The collapse of **Silicon Valley Bank** and **Signature Bank** set off a chain reaction that extended to **Credit Suisse**. The bank has no direct or indirect exposure to either of the failed banks but untimely remarks from the **Saudi National Bank**, its biggest shareholder, triggered a loss of confidence. Deposit withdrawals mounted as Credit Suisse's bonds and shares sold off, forcing Switzerland's central bank to provide a CHF 50bn liquidity injection. The rescue has calmed markets down for the moment but the central bank, the regulatory authority (FINMA) and the Federal Council will now be closely watched for any bigger involvement. In the meantime, risk premiums in the sector will no doubt stay high.

CONVERTIBLES

In a very volatile week, financials in the US and Europe were the main subject. Caution was in evidence on convertible markets but there was no panic. Overall, the asset class proved rather resilient in the market sell-off, mainly due to its limited exposure to financials; they represent no more than 2% of equity sensitivity in Europe. Major US convertible issuers were not directly exposed to **SVB** or **First Republic Bank**. In new issuance, pet food distributor **FreshPet** raised $350m at 3% due 2028. The proceeds will go on international investments.

GLOSSARY

• Investment Grade: bonds rated as high quality by rating agencies.

• High Yield: corporate bonds with a higher default risk than investment grade bonds but which pay out higher coupons.

• Senior debt benefits from specific guarantees. Its repayment takes priority over other debts, known as subordinated debt.

• Debt is considered to be subordinated when its redemption depends on the earlier payment of other creditors. To offset the higher risk, subordinated Senior debt has priority over other debt instruments.

• Tier 2 / Tier 3 : subordinated debt segment.

• Duration: the average life of a bond discounted for all interest and capital flows.

• The spread is the difference between the actuarial rate of return on a bond and the rate of return on a risk-free loan with the same maturity.

• The so-called "Value" stocks are considered to be undervalued.

• Markit publishes the Main iTraxx index (125 leading European stocks), the HiVol (30 highly volatile stocks), and the Xover (CrossOver, 40 liquid and speculative stocks), as well as indices for Asia and the Pacific.

• EBITDA: Earnings before Interest, Taxes, Depreciation, and Amortization.

• Quantitative easing describes unorthodox monetary policy from a central bank in exceptional economic conditions.

• Stress Test: a process which simulates extreme but possible economic and financial conditions so as to assess any impact on banks and measure their resilience to these events.

• The PMI, for "Purchasing Manager's Index", is an indicator of the economic state of a sector.

DISCLAIMER

17/03/2023

This document is issued by the Edmond de Rothschild Group. It is not legally binding and is intended solely for information purposes.

This document may not be communicated to persons located in jurisdictions in which it would be considered as a recommendation, an offer of products or services or a solicitation, and in which case its communication could be in breach of applicable laws and regulations. This document has not been reviewed or approved by a regulator of any jurisdiction.

The figures, comments, opinions and/or analyses contained herein reflect the sentiment of the Edmond de Rothschild Group with respect to market trends based on its expertise, economic analyses and the information in its possession at the date on which this document was drawn up and may change at any time without notice. They may no longer be accurate or relevant at the time of reading, owing notably to the publication date of the document or to changes on the market.

This document is intended solely to provide general and introductory information to the readers, and notably should not be used as a basis for any decision to buy, sell or hold an investment. Under no circumstances may the Edmond de Rothschild Group be held liable for any decision to invest, divest or hold an investment taken on the basis of these comments and analyses.

The Edmond de Rothschild Group therefore recommends that investors obtain the various regulatory descriptions of each financial product before investing, to analyse the risks involved and form their own opinion independently of the Edmond de Rothschild Group. Investors are advised to seek independent advice from specialist advisors before concluding any transactions based on the information contained in this document, notably in order to ensure the suitability of the investment with their financial and tax situation.

Past performance and volatility are not a reliable indicator of future performance and volatility and may vary over time, and may be independently affected by exchange rate fluctuations.

Source of the information: unless otherwise stated, the sources used in the present document are those of the Edmond de Rothschild Group. This document and its content may not be reproduced or used in whole or in part without the permission of the Edmond de Rothschild Group.

EDMOND DE ROTHSCHILD ASSET MANAGEMENT (FRANCE)

47, rue du Faubourg Saint-Honoré 75401 Paris Cedex 08

Société anonyme governed by an executive board and a supervisory board with capital of 11.033.769 euros

AMF Registration number GP 04000015

332.652.536 R.C.S. Paris