EDMOND DE ROTHSCHILD

MARKET FLASH: VOLATILITY AND NERVOUSNESS

• The Swiss government approved the sale of the troubled Credit Suisse to UBS but chiefly at the expense of AT1 bond holders.

• Reacting to strong growth and higher-than-expected inflation, the Fed unsurprisingly increased its benchmark rates by 25bp.

• We are still negative on equities and we are neutral on duration.

Uncertainty dominated after regulators and central banks intervened over the weekend to stop the interbank market situation worsening. The Swiss government approved the sale of the troubled Credit Suisse to UBS but chiefly at the expense of AT1 bond holders. The move reassured investors that Europe's banking sector would not be caught up in the crisis.

Central banks followed the previous week's move by the ECB and raised rates. Reacting to strong growth and higher-than-expected inflation, the Fed unsurprisingly increased its benchmark rates by 25bp. However, at the press conference, Jerome Powell said there was more uncertainty over future hikes and that the consequence of the bank crisis would weigh. The Fed's dot plot suggests that any further hike will certainly be the last. Jerome Powell's more measured tone reassured markets but Janet Yellen's comments to a Senate commission rekindled risk aversion by asserting that there were no plans to introduce a universal depositor guarantee. A blanket guarantee would be tricky politically but it would certainly restore confidence in the banking system.

The Bank of England and the Swiss National Bank raised rates by 25bp and 50bp. Both banks said they were seeking to fight inflation while recognising current uncertainties.

The minutes from the last Bank of Japan meeting showed a gradual shift, with several references to wage increases. To justify the comments, inflation ex food and energy then rose to 3.5%, or more than the 3.4% expected.

China's central bank moved in the opposite direction and injected liquidity by cutting minimum capital requirements for banks by 25bp. This is only confirmation of the bank's pro-growth stance and its determination to bolster the recovery.

Both the US and European bank sectors are still struggling with uncertainties and the consequences will affect economies, notably by restricting access to loans. As a result, we are still negative on equities. We are neutral on duration even if it offers a haven during bouts of risk aversion. However, current government bond yields are incompatible with central bank objectives to get inflation down.

EUROPEAN EQUITIES

Indices recovered after UBS paid CHF 3bn, a 59% discount, to acquire **Credit Suisse**. Switzerland's central bank said it would provide CHF 100bn in liquidity, an amount that was matched by the Federation. The deal's terms raised hackles because shareholders were prioritised over holders of AT1 bonds. The ECB immediately assured markets that it would respect the traditional pecking order and that equity would be called on to absorb losses before AT1 instruments. ECB chair Christine Lagarde told the European parliament that inflation was still a key concern and that the bank would stay data dependent when considering any further rate hikes.

Tech drove gains this week on expectations that the pace of rate increases would slow. German software company **Nemetschek**, which is specialised in construction, reported a sharp drop in results but guidance reassured markets. In contrast, France's **Esker** fell on its guidance even though its results were in line. Results at renewable energy group **Voltalia** missed but the group maintained guidance.

In M&A, **Liberty Global** launched a bid on Belgian internet provider **Telenet** at €22 a share, or 59% above the last quoted price. The rebound in European car sales continued for the seventh month in a row with car registrations rising 11.5% in February.

US EQUITIES

In another week of strong performance deviation, the Nasdaq ended the last 5 trading sessions down 0.29% while the S&P 500 gained 0.6%. Within the S&P, there was significant sector divergence with only IT and Communication Services ending higher while Energy shed 1.36%.

Central bank rate increases rekindled worries over the stability of banks.

As expected, the Fed raised rates by 25bp but seemed to suggest that the cycle could possibly be drawing to a close. At the same time, Jerome Power said he was not expecting any rate cuts this year, unlike investors who are banking on several. Fed Fund futures see rates settling at 4.1% in 2023.

Janet Yellen, meanwhile, triggered a market sell-off when she said the government was not going to extend depositor guarantees or offer overall guarantees to savers. Her comments sent medium-sized banks and small/midcaps lower. She then went onto to say the US banking system had stabilised thanks to action from the FDIC, the Fed and The Treasury and added that new measures to protect bank deposits might be necessary if there were to be a run on small banks.

Money market funds saw inflows of $117bn over the week, down from the previous week's $150bn record.

In company news, **Nike** shed 2% after beating sales expectations but with lower margins. **Netflix** jumped 9% after a YipitData report claimed subscriptions in Canada had improved, thanks mainly to efforts to curb password sharing. **Ford** said its EV division would lose $3bn this year but could make a profit in 2026. **Block** sank 14.82% after the **Hindenburg Research** bureau shorted the stock, citing fraudulent behaviour and accusing the company's internal compliance system of adopting a "Far West" approach.

Social network stocks like **Meta** and **Snap** gained ground after **TikTok**'s CEO, Shou Zi Chew, appeared before the House of Representative's energy and trade commission Regional banks **First Republic** and **PacWest** tumbled 6% and 8.55% as investors continued to weigh the situation with banks after the Fed continued with its rate increases.

Coinbase plunged 14.05% after the SEC identified potential violations of securities law. **Oppenheimer** then downgraded the stock from "outperform" to "perform in line", citing the SEC statement and concerns over block chain's development in the US.

JAPANESE EQUITIES

Japanese equity markets bounced back from concerns over systemic risk in the global financial industry after US and European bank failures. The NIKKEI 225 and TOPIX rebounded by 1.51% and 1.04% for the period thanks to **UBS**'s rescue acquisition of **Credit Suisse** as well as an agreement by six major central banks to provide liquidity to markets. Markets were also underpinned by investors buying into high dividend stocks towards the end of FY2022. Growth stocks outperformed value after the Fed raised rates by 25bp and the chances of more hikes receded.

Rubber products and Electric Appliances gained 2.74% and 2.70%, respectively. In the Electric Appliances sector, **Tokyo Electron** advanced by 4.07% and **Kyocera** added 3.68%. Banks initially rose as fears over financial stability abated but then dipped. Real Estate and REITs were weak. **Sumitomo Realty & Development**, **Mitsubishi Estate** and **Mitsui Fudosan** shed 4.24%, 3.66% and 2.95%, respectively. Elsewhere, **Toshiba** agreed to a Tender Option Bond (TOB) proposed by **Japan Industrial Partners** to delist certain subsidiaries. The proposed acquisition amount is about 2 trillion yen.

Shinichi Uchida and Ryozo Himino took office as deputy governors of the Bank of Japan, effective March 20. Haruhiko Kuroda will step down as governor on April 9 and be succeeded by Kazuo Ueda. The yen rallied further to around 130 against the dollar on market expectations the pace of US rate hikes would slow.

EMERGING MARKETS

The MSCI EM Index was 3.71% higher as of Thursday's close. China and Chile led gains, up 5.64% and 4.92%. India, Taiwan and Mexico rose 1.18%, 4.07% and 3.96 %, respectively, while Brazil gave up 3.26%

In **China**, **Evergrande** is preparing for a restructuring agreement by the end of March as home inventories in 100 Chinese cities declined for the first time in 51 months. Beijing approved 27 newly imported online games for 2023 and **Tencent**, **NetEase** and **Bilibili** received new licenses. 86 domestic games were also approved in March. Xi's visit to Moscow concluded on Wednesday with more than a dozen agreements bolstering cooperation in areas from trade to technology but nothing on a Siberian gas pipeline to avoid alienating Europe further. The $50 billion US Chips and Science Act will now bar firms that win grants to expand Chinese output by 5% in advanced chips and 10% for older technology but equipment replacement and process upgrades for existing capacity are not restricted.

Sunny Optical's 2022 results were in line with expectations thanks to robust performance from the vehicle lens business. **Tencent**'s fourth-quarter revenues beat estimates, albeit slightly, after 5 straight quarters of misses while management expressed optimism for China's consumption recovery in the coming quarters.

In **Taiwan**, export orders fell by 18.3% YoY with Chinese orders leading the decline (-35.5%). Taiwan's central bank raised key interest rates by 12.5bp to 1.875 %, with governor Yang Chin-Long maintaining his cautious stance.

In **India**, the government slashed the windfall tax on domestically produced crude oil but doubled it for diesel exports from March 21 to 1 Rupee/litre. India will spend about 980 billion rupees ($12bn) over the next two years to take the airport count from 148 to 220 by 2025, for which private builders will invest about $9bn and the state-run Airports Authority of India will bring the rest.

Last Saturday, India and the European Union concluded the fourth round of talks for a comprehensive free trade agreement. The next round of talks is planned for June 12-16.

In **Brazil**, interest rates were left unchanged at 13.75% and the bank adopted a hawkish tone. The CNPE approved a resolution that will increase the biodiesel blend to 12% from April. Market sentiment turned more negative with the postponement of the new fiscal framework announcement and the return of discussions on changing the inflation target.

In **Mexico**, exports of crude oil to the US rose by 485,000 b/d to 1.118m b/d (+77%) for the week ending March 17. Mexico's inflation came in at 7.12%, lower than forecasts and the odds that the central bank will reduce the pace of what has been a record monetary tightening cycle at next week's meeting have risen.

On the supply-chain-relocation front, **Qualcomm** will be among the first customers for **TSMC**'s 4nm technology in its Arizona Fabs. **Apple** is seeking changes in India's labour laws as part of its effort to expand local production. Tamil Nadu state, where Apple's top supplier **Foxconn Technology Group** runs the nation's largest iPhone plant, is considering passing new rules that will make factory shifts more flexible and improve female participation in the labour force.

CORPORATE DEBT

CREDIT

Credit markets had an eventful week mainly because of the **Credit Suisse** debacle. Over the weekend, the Swiss National Bank, the country's regulator (FINMA) and the Federal Council organised the ailing bank's takeover by UBS. FINMA approved a CHF 3bn share swap while wiping out all Credit Suisse's CoCos.

The bank has seen a capital flight of around CHF 10bn a day since March 15 so the good news for the global banking system was that systemic risk had been avoided. Markets accordingly rose on the following Monday.

However, the deal flouted the conventional creditor hierarchy which has shareholders bearing losses before bonds are affected. All Credit Suisse CoCos were wiped out -a move that meant a new emergency law had to be passed over the weekend- and the AT1 market quite logically plunged on Monday March 20, with prices down by 15 points on average. However, the Bank of England, the European Banking Authority, the SRB and the ECB clubbed together to stop the sell-off with a declaration on the same day stressing that they would respect the traditional bank resolution hierarchy. CoCos ended the day 8% lower and the rebound continued on the following day. Over both trading days, the damage was reduced to a (still significant) 4% drop.

High yield premiums widened in sympathy initially but gradually returned to around 500bp both for CDS and cash bond indices, a show of some resilience in a volatile financial sector. Investment grade premiums followed a similar trajectory, first widening towards 190bp before dropping back to 170bp.

As of Thursday evening, investment grade had returned 0.4%, taking YTD gains to 1.9%. High yield also gained 0.4%, or 2.15% since January 1st. At the time of writing, actuarial yields for investment grade were 4.1% and 7.5% for high yield, still good entry points for carry strategies.

CONVERTIBLES

It was a busy week for global convertibles. In Europe, sportswear companies **Adidas** and **Puma** were under pressure after US sports retailer **Nike** lowered its gross margins expectations.

Real estate remained the main laggard, with **Vonovia** and **Aroundtown** down the most. In single name news, **Sanofi** surprised the market with positive Phase III results for Duxipent, a potentially substantial market opportunity for the company. **Morphosys** announced a tender offer for approximately €120m of the €325m convertible bonds outstanding at a purchase price between 60-64% each.

The primary market remained active, especially in Europe, **Wendel** launched an exchangeable bond into **Bureau Veritas** raising €750m due 2026 and creating a new underlying for the European convertible bond market.

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.

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