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Daily Intelligence Briefing

Wednesday, March 15, 2023

Identifying Change-Driven Investment Themes

I. Today's Thematic Investment Idea

A deep dive into a market driver with alpha generating potential.

Credit Suisse Leads European Banking Breakdown, Complicating Imminent ECB Meeting Outlook

Summary: Following a week of tumult in the US banking space, shares of European financials are breaking down as the probability of a Credit Suisse default surges. With $760 billion in assets, the Swiss bank is vastly larger and carries wider international exposure than the recently defunct Silicon Valley Bank and Signature Bank. Credit Suisse experienced significant outflows of client money in Q4 and had previously been forced to dip into liquidity buffers.

Risks to the EU's banking system are on the rise just one day before the European Central Bank's Governing Council is scheduled to make a decision on whether or not they will hike rates again. Core inflation in the Eurozone has yet to reverse course, touching another all-time high in February, and ECB policymakers had previously targeted a 50bps raise this month. While that hike remains likely, the central bank's policy outlook may now be impacted by emerging uncertainty.

Related ETFs: iShares MSCI Europe Financials ETF (EUFN), iShares MSCI Eurozone ETF (EZU)

The US financial sector has been slammed throughout the past week, largely due to fallout emanating from the collapse of Silicon Valley Bank (SVB) and subsequent shuttering of Signature Bank. MRP discussed some of the issues behind SVB's sudden insolvency in Monday's Intelligence Briefing, and it appears that aftershocks from the bank's meltdown are now cropping up across the Atlantic in Europe.

Shares of European banks had already been languishing this week, but several key banks, including Credit Suisse, BNP Paribas, Societe Generale, and others slid even more precipitously during Wednesday's European trading session. The STOXX Europe 600 Banks Index was down by just about -7.0% this morning, compounding a -14.4% drop in value since the start of the month. This rout has wiped out nearly all of the index's gains for the year to date.

Credit Suisse, which has faced several bouts of turbulence over the past few years, was down more than -28.5% at the US open, pushing the Swiss bank's shares toward new all-time lows. Panic kicked off this morning as the bank's largest shareholder, the Saudi National Bank (SNB), ruled out new assistance to the bank. SNB noted that its 9.8% ownership position in the bank is the maximum stake they are willing to take on, citing new regulatory rules taking effect when a shareholder owns more than a tenth of a firm. In an interview with Reuters, SNB Chairman Ammar Al Khudairy tried to calm investors by noting that Credit Suisse was "a very strong bank", but that reassurance appears to have fallen on deaf ears.

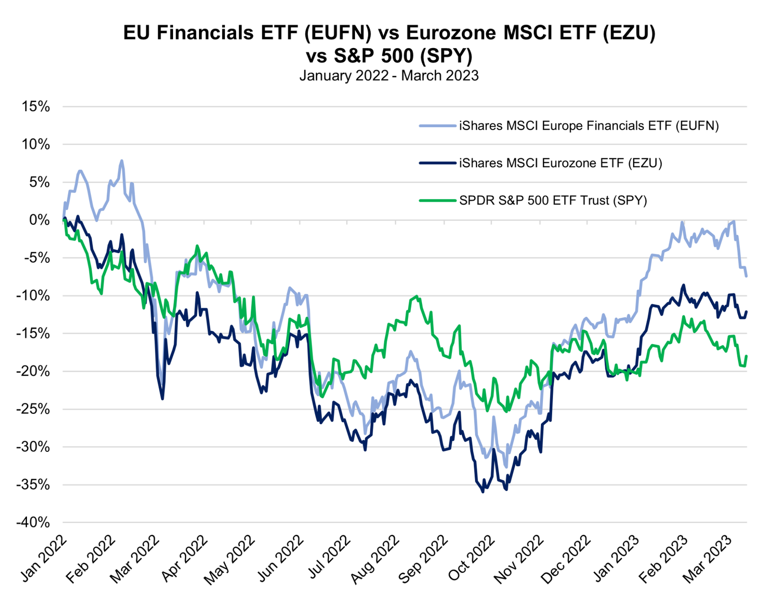
Per the Financial Times, spreads on the bank's five-year credit default swaps — which indicate investor assessment of the likelihood of a debt default — widened to 565bps on Wednesday, from 350bps at the start of the month. Bloomberg notes that outflows of CS's client money have yet to reverse as of this month, according to the bank's annual report released Tuesday. The bank confirmed it had dipped into liquidity buffers as a result of the withdrawals. New net money deposited in the bank fell by -110.5 billion francs (-$119.8 billion) in the fourth quarter, indicating massive withdrawals throughout the end of last year.

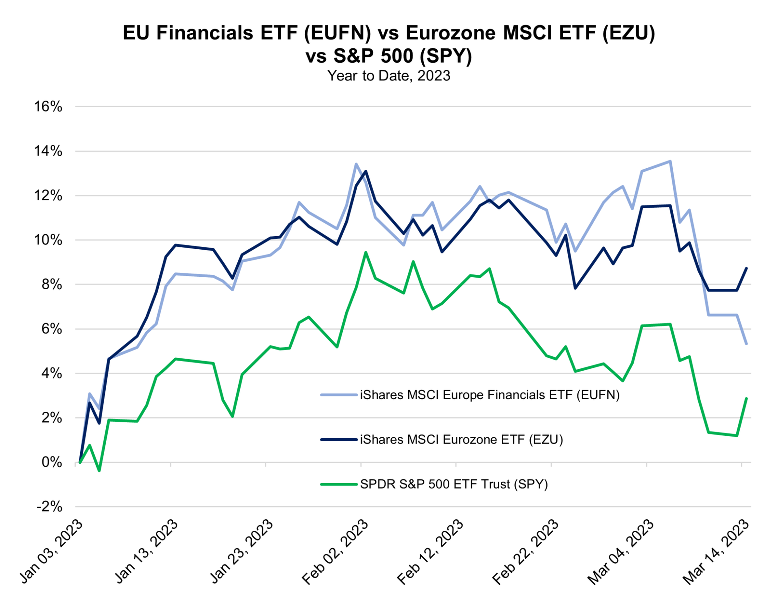
Though US banking industry turmoil has effectively eliminated expectations of a 50bps rate hike by the Federal Reserve in March, and thrown the prospect of any rate hike at all into serious question, reports indicate that the ECB is likely to continue upon their projected policy path and raise their benchmark short-term rate by another 50bps when its Governing Council meets tomorrow. ECB policymakers have committed themselves to such a hike for some time and, while it's unlikely that they make a last-minute adjustment, emerging volatility in the banking sector could make the bank revise its path forward. Expecting a particularly dovish shift in Europe would likely require a serious crisis, given how entrenched inflation remains in many sections of the EU. The annual change in the Euro Area's headline CPI has come down from a peak of 10.6% in October of 2022 to 8.5% in February, but that is largely due to a subsiding of volatile energy and food prices. The Euro Area's core CPI, which excludes food and energy, is still rising – hitting an all-time high of 5.6% in its most recent print.

It's difficult to know whether or not multiple European banks are under the same level of stress that the US regional banking space appears to be at this point, but we do know that the pressure of rapidly-rising short-term rates played a significant role in the collapse of SVB. Though SVB and Signature Bank were mid-sized institutions, Credit Suisse is a much larger bank, carrying almost $760 billion in assets, compared to $215 billion in SVB and $113 billion at Signature.

The ECB has little choice but to continue raising their own rates to some degree if they want to contain and reduce inflation anytime soon, but if they continue lifting interest rates at the pace they had planned, the central bank could run into problems similar to those which the Fed has inadvertently created. Speaking to Reuters, Marcel Fratzscher, the president of German economic research group DIW, cautioned that European banks are not totally out of the woods when it comes to the contagion risks of the banking downturn in the US, adding that German banks have yet to fully recover from the last financial crisis in 2008. Investors can gain exposure to European banks via the iShares MSCI Europe Financials ETF.

CHARTS





EUFN Top 10 Holdings	Weighting
HSBC Holdings Plc	8.48%
Allianz SE	5.62%
Zurich Insurance Group Ltd	4.20%
BNP Paribas S.A. Class A	4.19%
UBS Group AG	4.10%
Banco Santander, S.A.	3.80%
AXA SA	3.50%
ING Groep NV	2.91%
Munich Reinsurance Company	2.90%
Banco Bilbao Vizcaya Argentaria, S.A.	2.67%

Supplemental material for today's market insight...

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Banks

Credit Suisse Stock Price Drops 30% to New Low as Jitters Mount

Prices on Credit Suisse bail-in bonds, which get wiped out in case the bank runs into serious trouble, also fell. Bid prices on the 2027 bonds on Tradeweb slid to 45 cents on the dollar from 72 cents the day before. They traded close to 90 cents at the start of the month. Chairman Axel Lehmann said the prospect of government assistance is "not a topic whatsoever."

Read the full article from The Wall Street Journal +

Banks

Credit Suisse Default Swaps Are 18 Times UBS, 9 Times Deutsche Bank

The cost of insuring the bonds of Credit Suisse Group AG against default in the near-term is approaching a rarely-seen level that typically signals serious investor concerns.

The last recorded quote on pricing source CMAQ stood at 835.9 basis points on Tuesday. Traders were seeing prices of as high as 1,200 basis points on one-year senior credit-default swaps Wednesday morning.

Read the full article from Yahoo Finance +

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VIEWPOINT ARCHIVE

TOP

Joe Mac's Viewpoint

Founder Joe McAlinden's big-picture analyses of macro issues. More about him here.

March 3, 2023: **A Tough and Tighter Year Ahead →**

January 11, 2023: **A Look Back at 2022: Reviewing Our List of Themes →**

November 22, 2022: **Less Rich, But Not Cheap →**

October 4, 2022: **The "Real" Rate Story →**

August 8, 2022: **The FX Timebomb →**

ACTIVE THEMATIC IDEAS

TOP

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