# Letter from the CIO

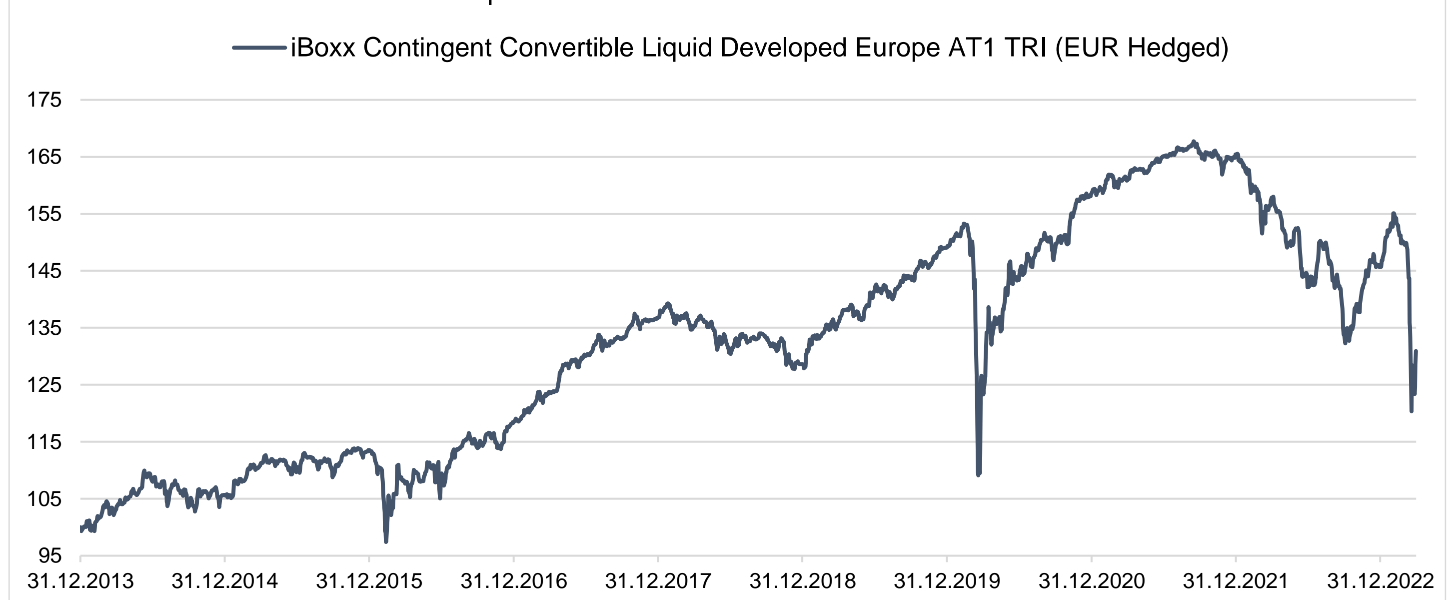
April 2023

## A viability event

If investors had to pick the most important event of March 2023, they would have lots to choose from: Distress in banks, Credit Suisse & AT1 write-down's, central bank meetings and last but not least China's president Xi-Jinping visiting Putin in Russia. When looking at the +3.16% monthly return of the MSCI World Equities index, one would not immediately realize that financial markets experienced the most volatile month so far in 2023 with the VIX reaching a YTD high at 26 index points around mid-March. While the financial sector turmoil was triggered by distress coming from two US regional banks with spill-over effect on Credit Suisse, important central bank meetings took place with the delicate task to announce additional rate hikes. For once this year, US equities finished the month stronger than their European counterparts with the S&P500 returning +3.67% by outperforming the Euro Stoxx 50 that finished up by +2.01%. Flight to safety and rising probabilities of a mild recession brought the 10Y US-treasury yield back down to 3.47% from 3.92% at the beginning of the month. Naturally with decreasing yields, growth stocks strongly outperformed value stocks, both in the US and in Europe. While the MSCI US Growth index outperformed the MSCI US Value index with +7.84% vs -0.8%, the European Growth index did the same outperforming +3.42% vs -3.18%.

In Switzerland, the months of March and April are traditionally marked by dividend ex-dates for many Swiss companies in the SMI. While the price of the index was merely up +0.07% in March, total return including dividends was +1.59% undermining the heavy component of dividend pay-outs in the SMI. Obviously, the impact of Credit Suisse's failure on the SMI's global performance was considerable with a negative a -0.7% contribution. Emerging market equities performed strongly as well returning +3.04% for the MSCI Emerging Markets. But the real star in March was Gold. Along with the decrease in yields coupled with an underperforming US dollar (DXY index -2.25%), Gold ended the month with a return of +7.8% standing at 1'969.28 an ounce for gold spot.

The headline story in the SMI was, however, the end of Credit Suisse and its take-over by UBS. This event officially puts an end to the Credit Suisse (ex-Schweizerische Kreditanstalt) which had been founded in 1856 by Alfred Escher when the country needed to find ways to finance the expansion of its railroad network in Switzerland. This is a big challenge for UBS, which has to integrate Credit Suisse in a very short period of time. While the integration of Credit Suisse in UBS cannot be ruled as a complete surprise to market participants, the decision to completely write-down Credit Suisse's outstanding CHF 16Bn worth of nominals in CoCo bonds has sent a wave of disbelief amongst bond investors. FINMA decided to define the extraordinary government support (granting of credit lines to UBS/Credit Suisse) as a "viability event" and as a result instructed Credit Suisse to completely write down its AT1 instruments. The viability event was triggered by the fact that the Federal Council enacted the Emergency Ordinance on Additional Liquidity Assistance Loans and the Granting of Federal Default Guarantees for Liquidity Assistance Loans. This ordinance authorises FINMA to order the borrower to write down such AT1 capital or "CoCo" bonds. This decision not only made the seniority of bonds over equity questionable, as Credit Suisse shareholders are still to receive the price paid by UBS through an exchange of shares, but also sparked a contagion effect on the entire AT1 bonds segment. The ECB did not lose much time to calm down market participants by releasing a statement on March 20th that common equity instruments are the first ones to absorb losses, and only after their full use would Additional Tier 1 be required to be written down." The message by the ECB eventually led to some relief and support of the European AT1 bond market as the write-off optionality due to "viability events" and not necessarily thresholds of AT1 capital ratio requirements are rather a particularity to the Swiss CoCo bonds market, but not the European one. However, the Swiss decision is likely to lead those bondholders to consider legal action in the near future.




Source: Bloomberg / Banque Heritage

The trend in disinflation continued as observed in the latest readings on both sides of the Atlantic. For the first time since September 2021, US headline CPI fell below 6% to 5% YoY in March 2023, a level last seen in May 2021. However, it quickly became clear, from looking at the core inflation number, that the fall excluded components such as energy and food, which are mainly responsible for the disinflation as core inflation came out above (!) headline inflation at 5.6% YoY. Core elements in inflation remain sticky and have barely moved since the beginning of the year. The picture is similar in Europe where the monthly move was impressive in headline inflation, however, core inflation actually rose from 5.6% to 5.7% YoY.

Central banks have generally acted as expected announcing the policy rate hikes that were already widely discounted for. All eyes were on guidance as both, FED chair Powell as well as ECB president Lagarde had to cope with nervous markets due to the turmoil in banks while at the same time fulfilling their objective of price stability in both regions. The important message was that no further rate hikes have been pre-committed and that most FED members now see the current rate as the target rate. This was rather well taken by markets which was also reflected in the overall positive performance in the equity markets.

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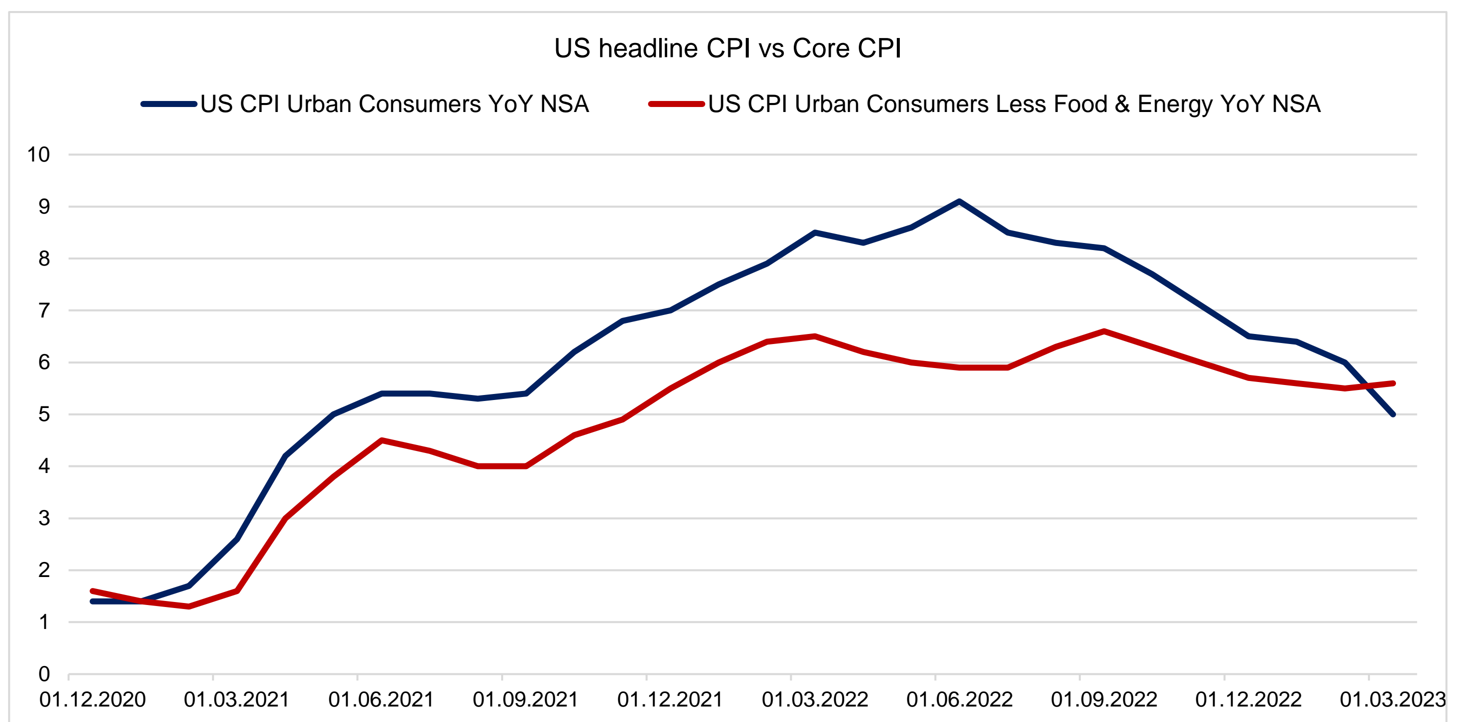


Source: Bloomberg / Banque Heritage

We have not taken any drastic measures in our portfolios over the course of March. We do believe that uncertainties in the banking sector should prevail even though the situation is not comparable to the Global Financial Crisis of 2008. This has led us to take profits in our European banking positions and increase our cash pockets slightly. Overall, we remain continuously optimistic and are looking forward to the upcoming Q1-2023 earnings season.


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