Lessons learned from the bank-run playbook

Global Matters Weekly

3 April 2023

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So far this year we've had very little respite from the relentless pace in markets. Russia continues to wage its atrocious and unprovoked war in Ukraine, a global recession looms, and the first quarter is ending with a bang as the dissolution of Credit Suisse into UBS has gripped investors' attention for the past two weeks. Still, just a couple of weeks ago*, you'd have been hard pushed to add another banking crisis to the list of market woes. Indeed, since the Global Financial Crisis, regulators have imposed a series of stringent checks and balances to ensure the health of the banking sector and avoid a repeat of 2008. Recent fears of 'national champion' bank solvency have certainly been overplayed, but whilst the systemic risks of 2008 remain improbable, liquidity risk has always been and will remain banks' proverbial 'monkey on the back'.

Banks constantly face liquidity risk given deposits held are subject to constant and sometimes unpredictable change. Terry Smith, manager of the Fundsmith strategy, recently recounted an anecdote whereby in the eighties, a local bank in China saw a group of people gather under an awning outside its building as they sought shelter from the rain. This led passers-by to believe that was the start of a bank run, which turned into a self-fulfilling prophecy. It doesn't take much to spook the markets, even if the fundamentals don't warrant it – an oft-reoccurring theme in the bank run playbook.

With the failure of Silicon Valley Bank on March 10, the global banking sector was shaken to its core, and nervous investors, long frustrated by Credit Suisse's poor performance and lack of profitability, started selling equity and debt, culminating with the Swiss National Bank (SNB) intervention which saw US$17 billion of Credit Suisse Additional Tier 1 (AT1) bonds getting wiped out. AT1 bonds (otherwise known as Contingent Convertibles or CoCos) are a tier of regulatory capital which itself is an amount designed as a buffer to absorb losses that might otherwise adversely affect the issuing firm and its creditors. Make no mistake though, the initial selling was not the result of savvy investors' fundamental analyses of Credit Suisse's business,

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but rather based on poorly informed and panic-driven inferences.

Yes, Credit Suisse had long been tarnished by a series of controversies (losing two Chief Executive Officers in the course of two years, suffering billions of dollars in losses – think Archegos and Greensill – and even getting marred in a drug cartel scandal!) which saw wealthy customers jump ship. And yes, Credit Suisse was the least profitable bank in the Euro Stoxx Index (the only one to have negative return on equity for the last five years), but its board of directors had begun a vital overhaul process involving changing the culture of the bank and raising sufficient capital to restructure the business (namely by spinning off its investment banking division). Despite all this, in the runup to the Swiss regulator's intervention on Sunday 19 March, the bank was very solvent, and even very liquid. In fact, its liquidity coverage ratio jumped to 190% following the 50 billion Swiss Franc injection by the SNB. Banks' liquidity positions are stress-tested every year by regulators and there were no concerns on this front. Unfortunately, this was not enough to reassure markets, hence the Swiss government forced through UBS' acquisition of Credit Suisse.

These events should serve as a stark reminder that it's easy to fall into a state of complacency from overly relying on quantitative indicators, but we cannot shun the importance of qualifying these with rigorous qualitative risk assessments. Indeed, fear and panic can rapidly take hold of investors, causing them to act irrationally, ultimately dismissing fundamental analysis and common sense. Importantly though, the market dislocations that result, often make for attractive valuation arguments and if coupled with solid fundamentals can produce compelling investment opportunities.

*Sources: * Deutsche at the time of writing (24/03/2023)*

NDL momentum

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The **Marketplace**

- Global equities returned 3.8% last week
- All significant indices returned positive performance into quarter end last week
- Brent crude rose 6.4% to $79.77 per barrel
- Gold returned -0.5% to $1969.28 per ounce

Market **Focus**

US

- US equities returned 3.5% last week, with oil, gas, and energy outperforming while regional banks and social media underperformed
- US core Personal Consumption Expenditure inflation rate decelerated more than expected to 0.3% month-on-month in February while slowing to 4.6% year-on-year
- US Conference Board Consumer Confidence for March was 104.2 (vs 101 expected)
- US financial officials outlined what may be the most significant regulatory overhaul of the banking sector in years after the Silicon Valley Bank (SVB) and Signature Bank chaos. The failures demonstrated "the implications that banks with assets of $100B or more can have for financial stability," Federal Reserve (Fed) Vice Chair for Supervision Michael Barr said. The Fed will enhance stress tests, and the Federal Deposit Insurance Corporation will explore deposit insurance tweaks. The Fed also launched a review of SVB supervision

Europe

- European equities returned 4.3% last week, with retail, travel, and leisure outperforming while food, beverage, and media underperformed
- European Consumer Price Inflation (CPI) plunged by the most on record to 6.9% in March, from 8.5% the previous month. But a new high of 5.7% for underlying price gains highlighted the tricky task facing the European Central Bank
- German CPI for March month-on-month was 0.8% (vs 0.7% expected), IFO Business Climate Index for March was 93.3 (vs 91 expected)

UK

- UK equities returned 3% last week
- Andrew Bailey (Bank of England Governor) said interest rates would probably stay below the highs before the 2008 financial crisis. Still, he reiterated that more tightening would be needed if inflation persists longer than expected

Asia/Rest of The World

- Global emerging markets returned 1.9% last week
- Japanese equities returned 3.7% last week
- Bank of Japan tweaked bond-buying plan as yields drop on banking concerns. They will buy ¥100- ¥500 billion ($752 million- $3.8 billion) of 10-to-25-year bonds, compared with ¥200-¥400 billion in the first quarter
- Chinese equities returned 2.3% last week. China Manufacturing Purchasing Managers Index for March was 51.9 (vs 51.5 expected)
- Investors continue to move into cash, with $60.1 billion in the week through Wednesday, according to Bank of America analysis of Emerging Portfolio Fund Research data. That brings the quarterly flow into cash to around $508 billion, the most since the very start of the pandemic

NDL momentum

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Asset Class/Region	Currency	Currency returns			
		Week ending 31 Mar. 2023	Month to date	YTD 2023	12 months
Developed Market Equities					
United States	USD	3.5%	3.6%	7.4%	-8.2%
United Kingdom	GBP	3.0%	-2.7%	3.2%	5.6%
Continental Europe	EUR	4.3%	0.8%	9.9%	4.5%
Japan	JPY	3.7%	1.7%	7.2%	5.8%
Asia Pacific (ex Japan)	USD	1.9%	2.8%	4.1%	-8.9%
Australia	AUD	3.2%	-0.2%	3.5%	0.1%
Global	USD	3.8%	3.1%	7.7%	-7.0%
Emerging markets equities					
Emerging Europe	USD	2.7%	-4.2%	1.5%	1.0%
Emerging Asia	USD	1.5%	3.6%	4.8%	-9.4%
Emerging Latin America	USD	5.7%	0.8%	3.9%	-11.1%
BRICs	USD	2.7%	3.2%	0.8%	-8.3%
China	USD	2.3%	4.5%	4.7%	-4.7%
MENA countries	USD	1.0%	0.7%	-1.8%	-20.9%
South Africa	USD	3.9%	3.3%	-0.6%	-20.6%
India	USD	2.8%	0.9%	-3.4%	-7.0%
Global emerging markets	USD	1.9%	3.0%	4.0%	-10.7%
Bonds					
US Treasuries	USD	-0.5%	2.9%	3.1%	-4.4%
US Treasuries (inflation protected)	USD	0.2%	2.9%	3.4%	-6.5%
US Corporate (investment grade)	USD	0.2%	2.6%	3.5%	-5.2%
US High Yield	USD	1.8%	1.1%	3.7%	-3.6%
UK Gilts	GBP	-1.5%	3.0%	2.2%	-16.7%
UK Corporate (investment grade)	GBP	-1.0%	0.9%	2.4%	-11.6%
Euro Government Bonds	EUR	-1.2%	2.4%	2.6%	-11.8%
Euro Corporate (investment grade)	EUR	-0.4%	1.0%	1.6%	-7.7%
Euro High Yield	EUR	0.8%	-0.4%	2.7%	-4.5%
Japanese Government	JPY	0.2%	1.5%	2.4%	-1.8%
Australian Government	AUD	-0.4%	3.7%	5.1%	0.4%
Global Government Bonds	USD	-0.6%	3.6%	3.2%	-9.0%
Global Bonds	USD	-0.3%	3.3%	3.3%	-8.4%
Global Convertible Bonds	USD	1.7%	0.4%	2.5%	-10.5%
Emerging Market Bonds	USD	0.4%	1.8%	1.9%	-8.4%

Source: Bloomberg. Past performance is not indicative of future returns

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Asset Class/Region	Currency	Currency returns			
		Week ending 31 Mar. 2023	Month to date	YTD 2023	12 months
Property					
US Property Securities	USD	5.9%	-2.7%	2.4%	-20.2%
Australian Property Securities	AUD	1.0%	-6.9%	-0.2%	-17.8%
Asia Property Securities	USD	0.6%	-0.1%	-3.2%	-11.8%
Global Property Securities	USD	4.1%	-2.8%	0.3%	-20.5%
Currencies					
Euro	USD	1.0%	2.5%	1.5%	-1.9%
UK Pound Sterling	USD	1.0%	2.0%	2.1%	-6.0%
Japanese Yen	USD	-1.6%	2.3%	-1.3%	-8.4%
Australian Dollar	USD	0.8%	-0.8%	-1.8%	-10.6%
South African Rand	USD	2.4%	3.4%	-3.9%	-17.5%
Swiss Franc	USD	0.6%	2.6%	0.9%	0.9%
Chinese Yuan	USD	0.0%	1.0%	0.4%	-7.7%
Commodities & Alternatives					
Commodities	USD	3.6%	-0.7%	-4.7%	-10.0%
Agricultural Commodities	USD	3.3%	0.8%	-0.4%	-8.1%
Oil	USD	6.4%	-4.9%	-7.1%	-26.1%
Gold	USD	-0.5%	7.6%	8.0%	1.3%
Hedge funds	USD	0.3%	-1.4%	-0.2%	-3.3%

Source: Bloomberg. Past performance is not indicative of future returns

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