ATLANTIC
FINANCIAL GROUP

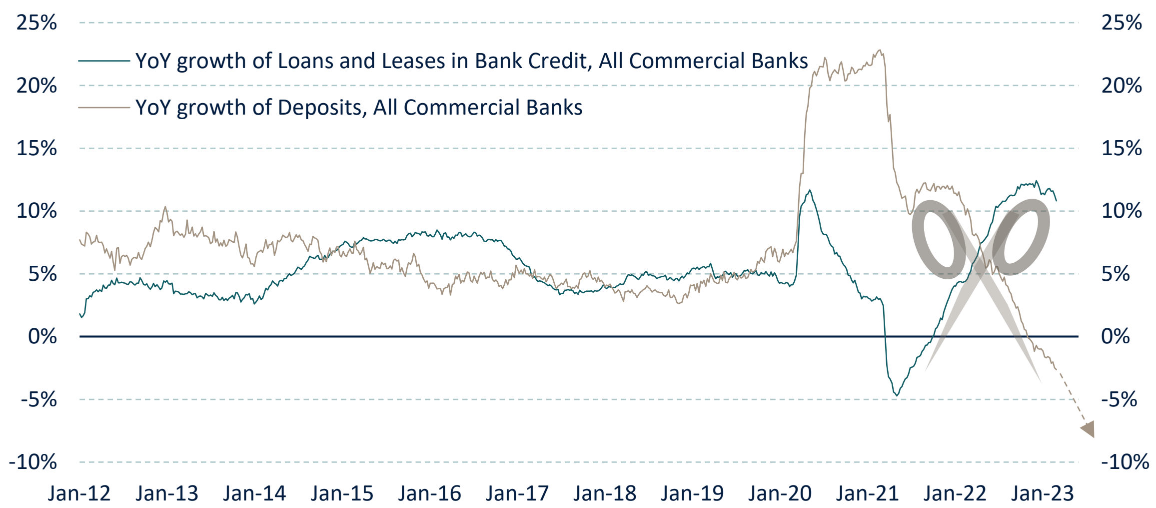
Weekly Investment Focus

20 March 2023

"THE BANKING SYSTEM UNDER THREAT OF THE SCISSOR EFFECT "

- How can we explain the setbacks of the US regional banks?
- Are these bankruptcies a sign of a new major crisis?
- Fed and Treasury actions reassure investors... temporarily
- European banks seem more relaxed after 15 years of regulatory rigour

GRAPHIQUE DE LA SEMAINE : "US Banks’ deposits are contracting"



Source: Federal Reserve Bank of St. Louis, Atlantic Financial

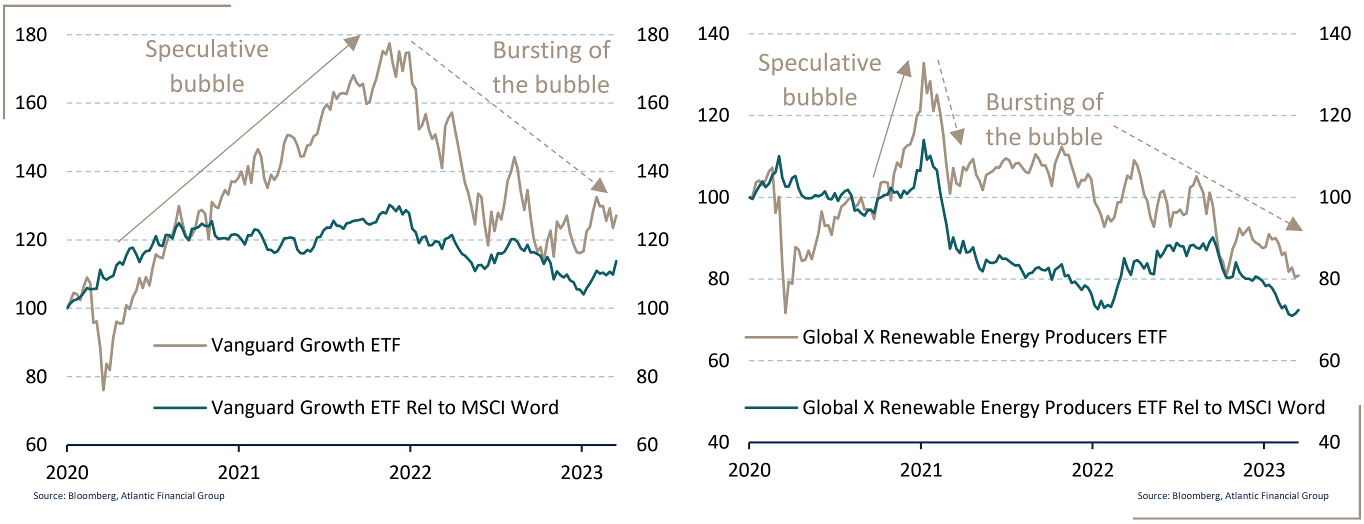
FINANCIAL MARKET ANALYSIS

The price of US banks, especially regional banks, plummeted following the bankruptcy of the Silicon Valley Bank (SIVB), now commonly known as the “National Bank of Santa Clara”, until its assets were completely liquidated. The banking sector, which seemed to have regained investor confidence, was affected globally as European banks also corrected strongly.

◆ How can we explain the setbacks of the US regional banks?

The bankruptcy of SIVB did not happen by chance. It is the result of several major crises that the authorities tried to contain. First, **the massive injection of cash into the economy during the covid-19 pandemic helped create speculative bubbles** in many markets including real estate, crypto-currencies and growth stocks such as electric vehicles or renewable energy (see Figs. 2 and 3).

Fig. 2 & 3 - Performance of growth stocks and renewable energy in the US



The growth in the balance sheet of California's regional banks reflects this massive influx of cash to finance the entire technology sector, from start-ups to large caps.

Secondly, **the supply problems during the Covid-19 pandemic and then the war in Ukraine accelerated the inflationary spiral**.

The final straw came with **the Fed's drastic change in monetary policy to contain inflation, quickly drying up the exuberant liquidity** of the covid years.

SIVB failed to manage the massive inflow of cash and the duration mismatch between assets and liabilities caused everything to fall apart as soon as deposits started to decline. It is certainly not the only bank. **Regional banks with less than $700 billion in assets had been receiving regulatory relief since 2018** and the Trump administration's famous **Economic Growth, Regulatory Relief and Consumer Protection Act.** They were therefore not under the same regulatory pressure as the large banks (G-SIBs).

Customers now prefer big banks like JP Morgan, Citi or Bank of America to open deposit accounts, knowing that they are very strictly supervised by the regulator and therefore certainly safer...

♦ Are these bankruptcies a sign of a new major crisis?

Historically, **bank failures have often been a precursor to major financial crises. It is** not uncommon for them to have a significant impact on the economy and the financial system as a whole.

The global financial crisis of 2008 was triggered in part by the collapse of several large banks and financial institutions in the United States, including the failure of Lehman Brothers.

The Asian financial crisis of 1997 had major economic repercussions throughout the region. Again, it was caused by the failure of several large Asian banks, which had accumulated high levels of non-performing loans.

The Swedish banking crisis of the late 1980s was caused by the mismanagement of mortgage loans and the bursting of the Swedish housing bubble. The banks suffered heavy losses and several of them went bankrupt, leading to a recession in Sweden.

The Depression of the 1930s was caused in part by a wave of bank failures, which swallowed up the savings of many Americans and contributed to widespread economic difficulties.

The failures of US regional banks are indicative of a malaise in the markets. The scissor effect on bank deposits (Chart of the week) is perhaps only the tip of the iceberg. Never before has so much liquidity flooded the market and **never before has monetary tightening dried up funding flows so quickly.** The increase in bond losses has coincided with a decline in bank deposits as savers seek higher returns as the Federal Reserve continues to raise interest rates.

♦ FED and Treasury actions reassure investors ... temporarily

The Fed, in agreement with the Treasury and the Federal Deposit Insurance Corporation (FDIC), quickly took steps to prevent SIVB bank run from spreading to other regional banks.

Banks in need of liquidity will therefore be able to call on the Fed in exchange for treasury bills recognised at their nominal value. That is, without taking into account the discount due to the rise in interest rates. In this way authorities hope to stem the flight of deposits. The regional banks will have to increase the yields on deposits (also called deposit beta) in order to retain customers. Competition between banks is likely to intensify and squeeze their margins.

Measures taken should be enough to reassure investors, but **clients continue to transfer their assets to larger, better supervised banks.**

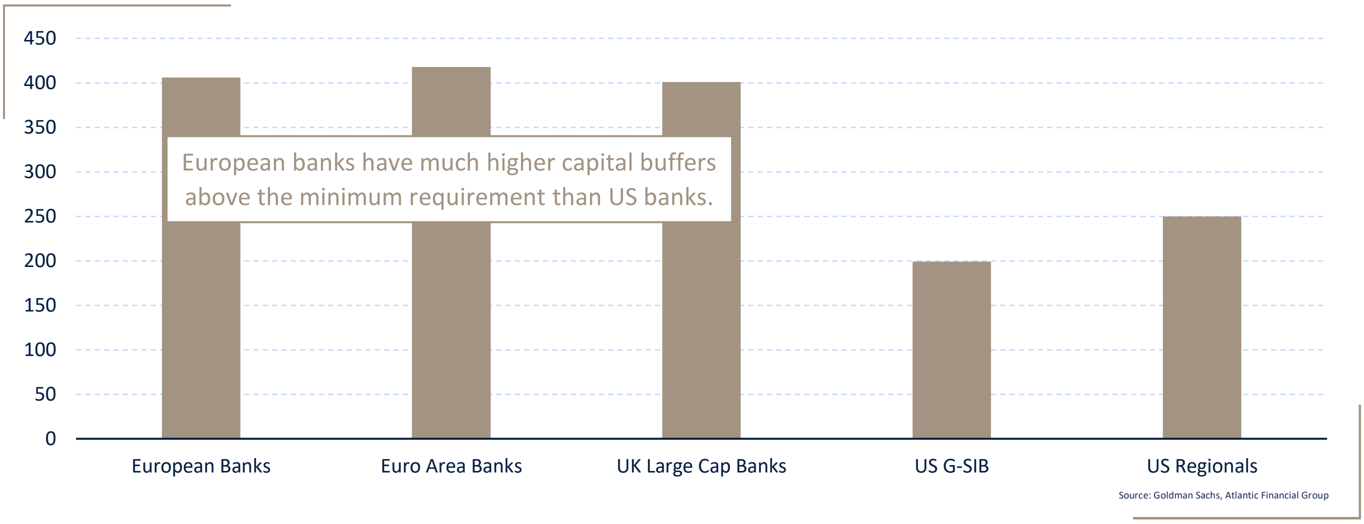
♦ European banks seem more relaxed after 15 years of regulatory rigour

European banks are not immune to recessions, but the last fifteen years of **restructuring and regulatory safeguards** have greatly strengthened the sector. European banks differ in important ways from US banks:

- European banks are **better capitalised** (see Fig. 4)
- They benefit from **low-cost, low-volatility deposits**
- They recognise losses on their asset for sale(AFS)

- They have more Held to Maturity (HTM) assets
- The **lending rate as a percentage of deposits is much lower** at 61% compared to 73% in the US. They therefore generate more income from deposit activities than from lending.
- The regulator ensures through annual stress tests that banks' balance sheets remain solid in the event of an adverse scenario or that the duration on assets/liabilities remains balanced.
- The ECB has recently approved numerous share buy-back programs, confirming at the same time the adequate level of capital of banks.

Fig. 4 - CET1 capital cushion above the minimum requirement (in basis points)



Conclusion:

The financial sector is showing worrying signs of weakness as interest rates rise too quickly. However, central banks are trying to offer comfort to investors and savers in order to avoid further bank failures and to stop any systemic risk at its source. The economic adjustment due to the ongoing monetary tightening may take time as the recession gains ground. The technology sector is the first to experience financing difficulties. It is expected to be followed by the real estate sector and the rest of the economy.

RETURN ON FINANCIAL ASSETS

Markets Performances (local currencies)	Last Price	Momentum Indicator (RSI)	1-Week (%)	1-Month (%)	2023 Year-to-Date (%)	2022 (%)	2021 (%)
Equities							
World (MSCI)	616.1	38.97	0.0%	-4.3%	2.2%	-17.9%	19.0%
USA (S&P 500)	3 917	44.05	1.5%	-3.8%	2.4%	-18.1%	28.7%
USA (Dow Jones)	31 862	36.68	-0.1%	-5.6%	-3.4%	-6.9%	20.9%
USA (Nasdaq)	11 631	53.56	4.4%	-1.2%	11.4%	-32.5%	22.2%
Euro Area (DJ EuroStoxx)	433.7	37.84	-4.2%	-5.6%	6.1%	-11.4%	23.5%
UK (FTSE 100)	7 335	27.03	-5.2%	-7.7%	-0.6%	4.6%	18.4%
Switzerland (SMI)	10 614	34.60	-0.8%	-4.5%	0.2%	-14.3%	23.7%
Japan (Nikkei)	26 946	45.65	-2.9%	-0.6%	4.8%	-7.3%	6.7%
Emerging (MSCI)	952	37.64	-0.3%	-4.6%	-0.2%	-19.8%	-2.3%
Brasil (IBOVESPA)	101 982	35.65	-1.6%	-6.6%	-7.1%	4.7%	-11.9%
Russia (MOEX)	2 323	64.24	2.0%	7.1%	8.1%	-36.9%	21.9%
India (SENSEX)	57 253	36.44	-1.9%	-4.9%	-4.5%	5.8%	23.2%
China (CSI)	3 938	39.05	-0.2%	-1.9%	2.3%	-19.8%	-3.5%
Communication Serv. (MSCI Worl	78.33	55.67	4.6%	-0.5%	11.5%	-35.3%	10.9%
Consumer Discret. (MSCI World)	296.4	40.13	0.4%	-5.9%	7.1%	-31.5%	9.2%
Consumer Staples (MSCI World)	263.3	44.21	0.7%	-1.7%	-1.0%	-6.0%	11.7%
Energy (MSCI World)	215.7	24.40	-7.5%	-9.0%	-9.6%	34.6%	37.5%
Financials (MSCI World)	124.0	21.45	-5.8%	-11.9%	-5.7%	-9.2%	25.1%
Health Care (MSCI World)	322.4	37.95	1.1%	-4.1%	-5.3%	-5.7%	18.0%
Industrials (MSCI World)	287.9	36.32	-2.3%	-4.5%	1.8%	-12.6%	16.6%
Info. Tech. (MSCI World)	448.2	59.39	4.6%	1.5%	14.4%	-30.9%	27.6%
Materials (MSCI World)	307.2	27.88	-2.6%	-5.9%	-0.7%	-11.0%	15.4%
Real Estate (MSCI World)	167.9	29.33	0.1%	-7.6%	-1.9%	-24.0%	23.6%
Utilities (MSCI World)	145.1	48.00	2.2%	-2.0%	-3.6%	-3.8%	11.1%
Bonds (FTSE)							
USA (7-10 Yr)	3.33%	66.63	2.3%	3.7%	4.3%	-14.5%	-2.4%
Euro Area (7-10 Yr)	2.82%	63.43	2.7%	2.5%	4.4%	-19.4%	-2.9%
Germany (7-10 Yr)	2.11%	64.10	3.0%	2.8%	3.6%	-17.8%	-2.7%
UK (7-10 Yr)	3.28%	67.02	2.7%	3.0%	4.5%	-17.1%	-4.9%
Switzerland (7-10 Yr)	1.00%	74.10	3.0%	3.5%	5.2%	-12.5%	-2.3%
Japan (5-10 Yr)	0.25%	73.17	1.2%	1.7%	1.7%	-2.8%	0.0%
Emerging (5-10 Yr)	8.12%	47.02	-0.5%	0.1%	0.8%	-17.4%	-2.3%
USA (IG Corp.)	5.30%	58.53	0.7%	1.0%	2.5%	-15.8%	-1.0%
Euro Area (IG Corp.)	4.22%	53.92	-0.1%	-0.1%	1.7%	-13.6%	-1.0%
Emerging (IG Corp.)	7.69%	50.06	-0.2%	-0.2%	1.3%	-14.9%	-3.0%
USA (HY Corp.)	8.98%	40.79	-0.1%	-0.7%	1.4%	-11.2%	5.3%
Euro Area (HY Corp.)	8.05%	26.85	-0.7%	-2.0%	1.7%	-10.6%	3.4%
Emerging (HY Corp.)	11.42%	31.18	-1.1%	-1.7%	-0.4%	-12.4%	-3.2%
World (Convertibles)	365.2	32.05	-1.1%	-3.8%	1.8%	-18.2%	2.4%
USA (Convertibles)	482.2	34.31	-0.9%	-4.1%	1.7%	-20.1%	3.1%
Euro Area (Convertibles)	185	35.45	-1.4%	-2.4%	2.2%	-12.1%	1.2%
Switzerland (Convertibles)	174.9	64.45	0.8%	0.5%	1.7%	-7.5%	-0.5%
Japan (Convertibles)	203.0	43.73	-1.7%	-1.1%	2.5%	-1.3%	3.3%
Hedge Funds (Crédit Suisse)							
Hedge Funds Indus.	741	65.39	n.a.	-0.9%	0.9%	1.0%	8.2%
Distressed	938	53.90	n.a.	0.1%	1.5%	-4.5%	12.5%
Event Driven	771	54.94	n.a.	-0.4%	1.8%	-6.8%	12.9%
Fixed Income	397	61.37	n.a.	0.6%	2.0%	-1.0%	5.2%
Global Macro	1365	53.93	n.a.	-4.8%	-2.2%	15.9%	9.6%
Long/Short	895	52.17	n.a.	-0.9%	2.4%	-5.8%	8.3%
CTA's	403	64.59	n.a.	1.8%	-0.9%	19.1%	8.2%
Market Neutral	296	64.31	n.a.	-0.4%	0.4%	1.7%	6.2%
Multi-Strategy	712	62.11	n.a.	0.3%	0.8%	1.3%	7.0%
Volatility							
VIX	25.51	59.21	2.9%	27.4%	17.7%	25.8%	-24.3%
VSTOXX	30.04	64.25	41.9%	56.2%	43.8%	8.4%	-17.6%
Commodities							
Commodities (CRB)	542.7	n.a.	0.0%	-1.5%	-2.2%	-4.1%	30.3%
Gold (Troy Ounce)	1 987	74.45	3.8%	7.9%	8.9%	-0.3%	-3.6%
Oil (WTI, Barrel)	66.74	28.95	-13.0%	-12.6%	-16.9%	4.2%	58.7%
Oil (Brent, Barrel)	70.53	n.a.	-12.3%	-15.0%	-17.0%	9.7%	51.4%
Currencies (vs USD)							
USD (Dollar Index)	103.84	46.92	0.2%	0.0%	0.3%	8.2%	6.4%
EUR	1.0665	50.66	-0.6%	-0.2%	-0.4%	-5.8%	-7.5%
JPY	131.20	63.27	1.5%	2.3%	-0.1%	-12.2%	-10.2%
GBP	1.2184	56.36	0.0%	1.2%	0.8%	-10.7%	-1.0%
AUD	0.6678	44.06	0.2%	-3.3%	-2.0%	-6.2%	-5.6%
CAD	1.3736	40.71	0.0%	-2.1%	-1.3%	-6.8%	0.7%
CHF	0.9253	52.22	-1.4%	-0.2%	-0.1%	-1.3%	-3.0%
CNY	6.8965	49.05	-0.7%	-0.6%	0.0%	-7.9%	2.7%
MXN	19.014	40.09	-0.5%	-3.3%	2.6%	5.3%	-3.0%
EM (Emerging Index)	1 675.5	50.12	0.5%	0.1%	0.9%	-4.3%	0.9%

Source: Bloomberg, Atlantic Financial Group

Total Return by asset class (Negative \ Positive Performance)

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