For professional investors only

Credit Suisse (SVB) Update

March 2023

Hot on the heels of the recent banking news in the US, we have seen further tensions develop over the past few days, but this time within Europe. Notably, it was Credit Suisse that has become the focal point, where trading was halted on March 15th, following a 20% fall in its share price. The ramifications were felt across the banking sector, with the fear that the market was possibly heading towards another financial crisis.

Credit Suisse has been somewhat of a problem child for several years now, with several Chairmen and CEO's rotating through the company in an effort to stabilise its deteriorating share price following a raft of negative headlines and results. The share price has fallen by c.70% since its post-Covid highs in March 2021, and even further if you go back to post the financial crisis.

The catalyst for this recent sell-off appears to be largely down to the Saudi National Bank stating that they would not increase their equity exposure further from their 9.9% holding. What's not clear however is whether this is all due to restrictions from European regulators, or if something deeper resides.

This is not however, the same situation as Silicon Valley Bank (SVB) which ended up having a 'bank run'. Most of SVB's deposits (which had grown remarkably quickly) came from corporations, mainly venture capital backed technology and/or start-up firms, which were then invested into long dated treasury bonds. As yields increased, the paper loss on the bonds held was significant. This is unusual in the core banking market for two reasons. Most banks have a diversified array of customers, with a large retail base whose deposits are stickier. Secondly, in the case of Credit Suisse, their bond exposure is short in duration (so less susceptible to rate increases) and, here's an important bit, its interest rate exposure is also hedged (any losses on rate rises were effectively offset).

The rationale for Credit Suisse's sell-off are completely independent from SVB's, however the timing of its news could not have come at a worse point. On 16 March the Swiss National Bank ("SNB") lent SwFr 50bn (USD 45bn) to Credit Suisse to strengthen its liquidity and stabilise the wider banking sector – which it appears to have done, for the time being. This was an important step taken by the SNB as the market was clearly trading on sentiment.

Square Mile's Managed Portfolios have minimal exposure to Credit Suisse shares and only through the passively managed funds, which is immaterial at the portfolio level. They do have more exposure in the global banking sector, which makes up a large part of stock-markets, amounting to c.4.2% in equities for a balanced model at the portfolio level.

The bond part of the portfolios has some minor exposure to Credit Suisse via its corporate bond holdings. However, given the vast number of corporate bonds that are typically held by fund managers we do not see it as a significant detractor in isolation. Many fixed income fund managers have been regarding banks as an appealing area to invest, for it is a sector which typically fares well when interest rates rise, so there is likely to be some wider contagion impact here, although limited.

Corporate bonds have two parts that drive their return – the credit risk and the interest rate risk – which offset each other in times of market stress. Credit spreads act a little more like equity markets, whilst the interest rate component will provide protection when markets begin to wobble. As of 16 March, £ Corporate Bonds indices are up between 2-3% depending upon which broad market index you look at.

As the wider banking community, for the best part, remains well capitalised we do not expect this to develop into a deeper banking crisis. However, we do fully expect the market to remain highly volatile for the time being.

We are continuing to monitor the situation in conjunction with our well-resourced Research team and through contact with the asset managers directly.

The Investment Management Team, Square Mile Investment Services
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