



## UBS Bank Bailout of Credit Suisse May Open Pandora's Box

The Silicon Valley Bank failure, originally considered a one-off event, is escalating and spreading. On Sunday afternoon, UBS, with significant liquidity and financial backstops from the Switzerland National Bank (SNB), bought Credit Suisse (CS) for about a third of its most recent market cap. The purchase may settle markets, but it potentially opens Pandora's box to more problems. For starters, harken back to Bear Stearns (BS). On a Sunday night almost 15 years ago, JPM bought BS for \$2, pennies on the dollar. Markets rallied as the banking crisis was thought to be contained. Only months later, that narrative fell apart. UBS bank may have bought time, but it is far from clear the problem is over. Might UBS bank also find itself in trouble?

Second and maybe more concerning, laws were changed, and bond rules were ignored to facilitate the takeover. In desperation, the Swiss government changed its laws so that CS equity holders will not have a vote in the UBS merger. Further troubling, CS will completely write off \$17 Billion of AT1 (*additional Tier 1, a.k.a. CoCo bonds*) Bonds. But, shareholders still receive \$3.2 Billion. According to law, equity holders are the lowest rung of corporate financial structures and are expected to take 100% losses before bonds lose a penny. Wiping out bonds before equity holders is unprecedented. European and Asian banks predominantly issue CoCo bonds. U.S. banks issue preferred shares instead of CoCo bonds. The Bloomberg graphic below shows that an Invesco AT1 ETF is trading down sharply.

# AT1 LN Equity Invesco AT1 Capital Bond UCITS ETF

At 05:09:23

## 18.10

**-3.855**  
USD

**-17.56%**

Open	18.50	High	18.97	Low	18.10
NAV	21.821	Mngr Fee	.39%	News	■■■■
Mkt Cap	376.32M	Vol	42,351		

Incepted on 06/25/18

### Price Chart 5 Year



## What To Watch Today

### Economy

Time	Event	Impact	Actual	Dev	Consensus	Previous
<b>TUESDAY, MARCH 21</b>						
12:55	USD Redbook Index (YoY)(Mar 17)	■	-	-	-	2.6%
14:00	USD Existing Home Sales (MoM)(Feb)	■	-	-	4.2M	4M
14:00	USD Existing Home Sales Change (MoM)(Feb)	■	-	-	0%	-0.7%
15:30	USD 52-Week Bill Auction	■	-	-	-	4.79%
17:00	USD 20-Year Bond Auction	■	-	-	-	3.977%
20:30	USD API Weekly Crude Oil Stock(Mar 17)	■	-	-	-	1.155M

## Earnings

- *No notable earnings releases today.*

## Market Trading Update

As the Fed starts its two-day FOMC meeting, the markets continue to tread water in anticipation of the announcement on Wednesday.

Despite the negative news headlines, the market remains above its December lows and retook the broken 200-DMA from last week. If the market can hold above that level for the week, then the bulls may be able to regain control of the narrative short term. Importantly, our MACD *"buy signal"* is again very close to turning from a decently oversold condition. While it did fail the last attempt, a positive signal would confirm that price action is more bullish, and we will need to increase exposure accordingly.

There is no rush to make any additions today, we will wait to see what the Fed has to say tomorrow and how the market responds. However, the market remains in a well-defined consolidation range since last June, and a bullish breakout to the upside will confirm the end of the bear market.

Be careful being *"overly bearish"* due to headline risk, the market continues to suggest decent underlying strength, and with the 50-DMA above the 200-DMA, the easiest path for prices remains higher near-term.

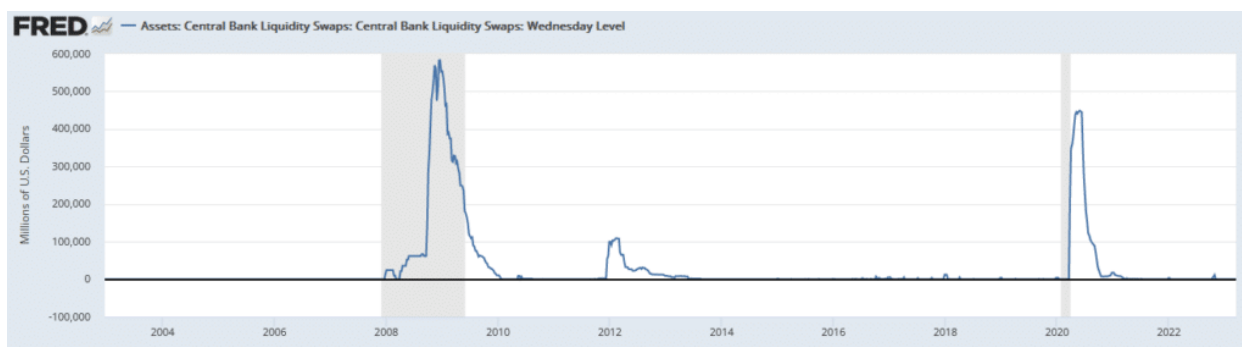


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## What Are Central Bank Dollar Swaps?

The Fed announced they will offer daily currency swaps as part of the CS bailout. These swaps are essentially collateralized dollar loans to foreign central banks. From the Fed's perspective, the loans stop central banks from having to sell U.S. Treasury securities to raise cash. They also provide central banks with needed dollar funding to pass on to their local banks. The bottom line—the Fed is indirectly helping or bailing out foreign banks. At the same time, they are making sure U.S. Treasuries do not get sold in mass and the dollar retains its value.

The graph below provides a history of the usage of the swap lines. Comparing what will occur to what occurred in 2020 and 2008 may guide us on the seriousness of foreign banking problems.



## Are Domestic Banks a Buy?

This is a tricky question; unfortunately, there is no good answer. As we are seeing, banks with strong balance sheets are being forced to sell underwater assets to meet depositor demands. As this occurs, the banks need capital which further worries existing depositors. No matter how strong a bank's balance sheet is, a bank run can bankrupt any bank, especially those with unrealized losses on their books, as all banks have now due to higher interest rates. Banks are historically cheap, but the unknowns are significant. The following quote comes from Vivek Juneja, a bank analyst from JP Morgan:

*We expect large bank stocks to remain choppy near term but for medium term holders the sector looks attractive due to cheaper valuation and stable/growing deposits, albeit with some uncertainty surrounding potential regulatory fallout. Large bank stocks are down 5-25% since March 8 when Silicon Valley Bank's issues unfolded - money centers are trading at 7.7x 2024 consensus EPS on average, well below 10.3x long-term average and regionals at 6.6x versus 11.4x long-term average.*

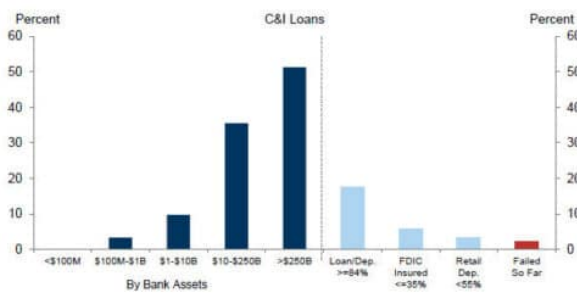
The graph below compares the regional bank ETF, KRE, to the broader financial sector ETF (XLF).



## Regional Bank Lending Matters

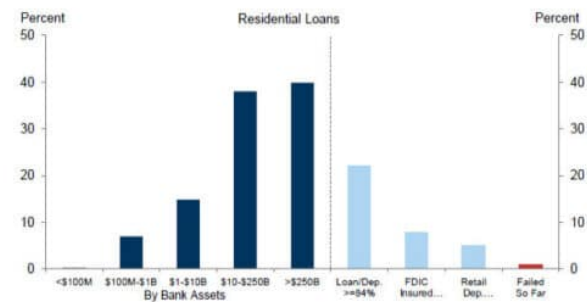
The economic aftershock from recent banking events will be problematic. The graphs below from Goldman Sachs show that small and medium-sized banks play a significant role in lending to many economic sectors. As all banks strengthen their balance sheet, they will tighten lending standards. It's highly likely, that small banks will tighten more than large banks. As shown below, small and mid-size banks originate 80% of commercial real estate loans. Given the importance of real estate to the economy, we suspect this sector will soon find it much more challenging to re-finance existing maturing deals. Further, new funding demands will become tougher to attain and weigh on construction spending and related employment. This helps partially explain why the REIT sector is falling with the financial sector.

Exhibit 1: Banks With Less Than \$250 Billion in Assets Account for About Half of All Commercial and Industrial Lending



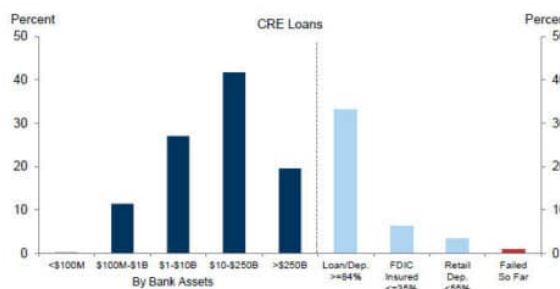
Source: Federal Deposit Insurance Corporation, Goldman Sachs Global Investment Research

Exhibit 2: Small and Medium-Sized Banks Account for 60% of Total Residential Lending



Source: Federal Deposit Insurance Corporation, Goldman Sachs Global Investment Research

Exhibit 3: Small and Medium-Sized Banks Account for About 80% of Total Commercial Real Estate Lending



Source: Federal Deposit Insurance Corporation, Goldman Sachs Global Investment Research

Exhibit 4: Small and Medium-Sized Banks Account for About 45% of Total Consumer Loans



Source: Federal Deposit Insurance Corporation, Goldman Sachs Global Investment Research

## Tweet of the Day



**Jonathan Ferro**  @FerroTV · 20h ...

“Quantifying the impact of tighter financial conditions plus tighter lending standards, we estimate that the events this past week correspond to a 1.5% increase in the Fed funds rate... the risks of a sharper slowdown in the economy have increased”

Apollo's Torsten Slok



19



53



216



36.5K



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