Elston

Elston Insights

30th March 2023

Navigating Sectors: Turbulent Financials

- Failure of SVB and Credit Suisse explored
- Fears of systemic risk elevated
- Reducing security-specific risk

The banking industry has been shaken by recent events, including the collapse of Silicon Valley Bank (SVB) and the troubles faced by Credit Suisse. These events have raised concerns about the health of the banking sector, and investors are fearful about whether to invest in financial stocks. We will explore the lessons that can be learned from these recent events and provide insights into how investors can navigate the turbulent waters of the banking industry.

What has happened to SVB?

The banking industry has been alerted by the recent failure of Silicon Valley Bank (SVB). SVB had a high proportion of its customers' deposits originating from a limited number of tech companies, and invested in bonds that were not safeguarded by any risk management techniques. These factors left SVB open to the possibility of losing its deposits. To address the issue, the Federal Reserve, US Treasury, and Federal Deposit Insurance Corp intervened to assure the safety of SVB depositors' funds. They introduced a new Bank Term Funding Program that provides easier loan terms to banks for one year, to prevent the risk of similar bank failures. Nevertheless, SVB's collapse has emphasized the necessity of regulatory oversight and the importance for banks to broaden their asset base and clientele.

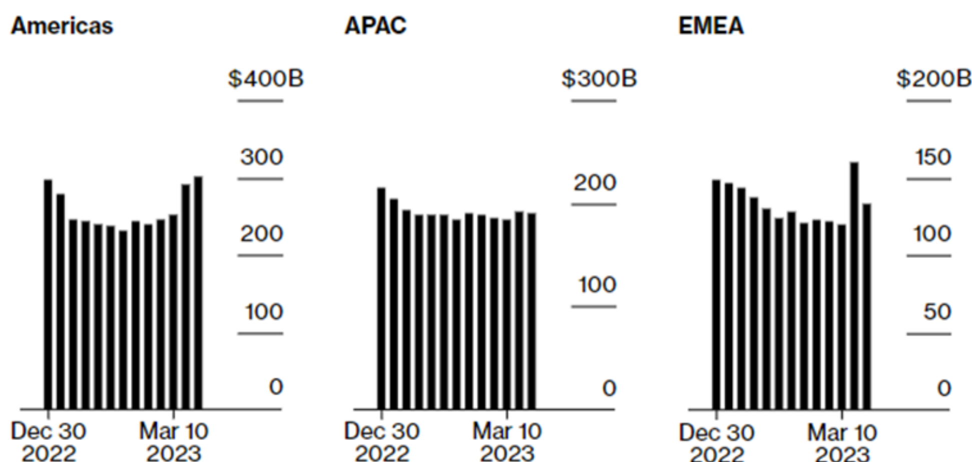
What has happened to Credit Suisse?

The recent problems at Credit Suisse have caused a stir in the banking industry, coming after years of ongoing issues. The bank's financial reporting was flagged by the SEC due to significant deficiencies, and concerns grew when its main shareholder, the Saudi National Bank, announced it would not be increasing its stake. To address these issues, Credit Suisse was sold to UBS. However, the sale has also raised concerns about the value of unsecured bonds (AT1s), which are a key part of the bank's capital. The challenges faced by Credit Suisse underscore the importance of robust risk management and continuous evaluation and improvement of business models for banks.

Systemic risk in European banks?

These events have caused concern among investors about the health of the banking sector. The collapse of US banks and Credit Suisse's merger with UBS have resulted in the amount of distressed corporate debt globally surging to $624 billion, with an increase of about $69 billion,

mostly in the US and Europe. Investors are worried about the ability of the weakest corporate borrowers to repay or refinance their debts, which could make it harder for companies to secure new financing through traditional debt markets. However, there is still optimism for the future of the banking industry. European banks appear to be well-capitalized and have faced stricter regulations since the Global Financial Crisis. Additionally, higher rates and the steepening of the yield curve are expected to boost earnings growth. Nonetheless, there is a risk that banks may restrict lending to the real economy due to recent financial stress, which could tighten the broader financial conditions.



In summary, the recent developments in the banking sector underscore the significance of effective regulatory supervision, robust risk management, and broadening asset and client base. Although the the banking industry has been under pressure on a firm-specific basis, investors can access this exposure using sector-specific ETFs, rather than making isolated calls on individual banks and/or their instruments.

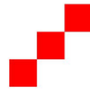
Andrea Acimovic, Associate

Elston Consulting

For all our Research & Insights, visit:

https://www.elstonsolutions.co.uk/insights

Elston



Find out more

For more insights and information on research, portfolios and indices, visit:

www.elstonsolutions.co.uk or NH ETF<Go>

www.elstonsolutions.co.uk

ABOUT ELSTON

We research, design and build investment solutions with and for asset owners, managers and advisers.

Our Research & CPD focuses on multi-asset strategies, index funds and ETFs.

NOTICES

With reference to the European Union Directive 2014/65/EU on markets in financial instruments ("MiFID II"): this Report does not provide a recommendation for an action, provides information freely available for public consumption and does not therefore constitute "Research" as defined by MiFID II. This is because this report contains purely factual information on one or several financial instruments or issuers and does not explicitly or implicitly recommend or suggest an investment strategy. It does not therefore constitute an investment recommendation as defined within the meaning of Article 3(1)(35) of EU Markets Abuse Regulation ("MAR"), in conjunction with Article 3(1)(34) of MAR. For further information, please refer to ESMA guidance ESMA70-145-111 Version 12.

With reference to the European Union's Market Abuse Regulation (Regulation (EU) 596/2014): we warrant that the information in this report is presented objectively, and the following commercial interests are hereby disclosed: Elston Consulting Limited creates research portfolios and administers indices that may or may not be referenced in this report. If referenced, this is clearly designated and is to raise awareness and provide purely factual information as regards these portfolios and/or indices.

An "Index" is a Regulated Benchmark. An "Index Portfolio" is not a regulated benchmark but a research portfolio of index-tracking investments with a periodic rebalancing scheme.

All company, product and service names and trademarks used in this article are for identification purposes only and are the property of their respective owners, and their usage does not imply endorsement.

This document is not an advertisement or financial promotion. It is provided for informational purposes only and is not intended to be an offer or solicitation, or the basis for any contract to purchase or sell any security or other instrument, or for Elston Consulting Limited to enter into or arrange any type of transaction as a consequence of any information contained herein.

This document is issued by Elston Consulting Limited registered in England & Wales, registration number 07125478, registered office: 1 King William Street, London EC4N 7AF.

© Elston Consulting Limited. All rights reserved No unauthorised reproduction.