Quick Rundown

With markets moving quickly, we will do a quick recap of where we are and what we think will be most important for markets this week.

It is a follow up to Saturday's Gasp, Gulp, Glug and Sunday's 8 Cup of Coffee Day. Academy was able to participate in Bloomberg's Banking Special yesterday and this portion of our interview (focused on AT1) was made into its own clip. And, finally, we got to wake up to Academy making it into the **NY Times** coverage of Investors Greet CS Deal Warily.

Biggest Concerns

The one thing that we did not get this weekend was an "explicit" guarantee of bank deposits in the U.S. It is "implicit" because depositors were saved at Signature Bank and Silicon Valley Bank using emergency measures, but it has not been made "explicit". As equity and credit analysts (and every private equity firm) question companies on their "cash and cash equivalents" line and demand to know where they are banking, more pressure will mount to continue to move out of deposits. I don't think it is a matter of safety, but one of expedience. What I've missed until this weekend is how problematic that is, not just for mid-size banks, but for the 100s or even 1000s of smaller banks that are highly regionalized or even localized. Many of these institutions are the lifeblood of daily business in those areas. **This could/should come, but until it does, there will be pressure on these banks (I like buying dips and growing an outsized position in this space) despite the lack of clarity.**

The decision to wipe out CS AT1 bonds. These bonds had been trading in the mid to high 80s (and even 90s as of March 10th) and traded at 2 today. I've read many arguments that "support" that decision, as these were meant to provide a capital "buffer" at times of stress, but the equity is getting paid and no official capital ratios were signaling a similar treatment here. **There are two problems with this from a European financial standpoint:**

- **Asset managers who own any AT1 paper will have to question that decision** and it will focus their attention on the weakest bank(s) in every country. The ability to raise this important level of capital is gone (at least for some time) and that affects many (if not all) banks in Europe.
- **The decision spreads "realized losses" outside of the banking system**. My understanding is that banks don't own much of each other's AT1 paper as the treatment is onerous. So, this means that it is spread throughout the financial system. Who knows what new trouble that might cause?

Back of Mind Concerns

No meaningful equity infusions into banks that have been trading poorly of late. This is only back of mind (rather than front and center) because explicit guarantees are an almost necessary condition for this to occur.

It seems odd to me that UBS stock is doing poorly, even relative to other European bank stocks. On the surface it seems that **either they got a good deal** (cost was low, the AT1 debt was wiped out, funding (albeit senior in bankruptcy funding) is available from the SNB, and there is some additional loss backstop being provided) **or the prices of other banks seem expensive**. It did not appear (from the series of press releases on Sunday) that UBS was an "enthusiastic" buyer which is also a concern given the fact that they had more time than anyone else to examine the books. However, even that time was short relative to the complexity of a major international finance company.

Central Banks are "selling" their cooperation (dollar funding lines, etc.) a little too hard. Concrete and unexpected action would be more helpful than just following what has become the standard "crisis" playbook.

Good(ish) News

No bank defaults in Europe. I don't think that anyone really thought this would happen so its only mildly positive and more than offset by the AT1 treatment.

Oil is below $65 for the first time since 2021! It is good from an inflation standpoint, but not sure what it means from an economic standpoint.

Fed balance sheet is growing! I think that markets are getting a little too excited about balance sheet growth because the 2020/2021 playbook of lower interest rates and balance sheet growth driving stock prices higher (especially the riskiest sectors) is fresh in everyone's mind. I think that Powell might have to discuss the possibility of suspending QT at this meeting.

Few if any more Fed hikes. I don't see how in this backdrop, where financial conditions are almost certain to tighten (due to funding pressure on banks), the Fed can ignore the lag effects. Yes, inflation has ticked up, but nothing right now is indicating that we are on a strong economic path until the banking concerns get resolved. Oil seems to support a pause too.

Bottom Line

The "bad news" is more European focused than U.S. so be cautious with Europe on the stock and bond fronts.

There is a very real possibility that we could see some action on bank deposit guarantees so I expect a bounce in U.S. stocks (especially the banks).

The easy money Fed trade is probably already overdone, but could easily continue (so fade that cautiously) especially with the possibility of some good news on the bank deposit front.

It is difficult to like interest rates at these levels, so reduce rate risk (at least for a trade) in the U.S.

Weirdly, the rallies in gold (balance sheet growth) and bitcoin (massive anti-bank and anti-establishment sentiment) make sense.

Good luck out there and be nimble, it seems like it could be another long week! Hopefully this note is still remotely relevant by the time you get it, especially in this crazy/headline driven market.

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