Zuger Kantonalbank

Portfolio – Update

20 March 2023

UBS is acquiring Credit Suisse (CS) by means of a share swap. This takeover was made possible by the combined support of the Swiss government, the Swiss Financial Market Supervisory Authority (FINMA) and the Swiss National Bank (SNB). The financial markets have swallowed this sedative pill for now, but are likely to remain jittery over the coming weeks. Investors should nonetheless keep calm and remain invested.

UBS takes over CS

UBS will take over CS in its entirety for the sum of around CHF 3 billion. In other words, it will be taking over not just the Swiss bank but also the Investment Banking division, which has become notorious in recent years for its negative headlines and large losses. Splitting up the bank would probably have been too complex as well as unfeasible in the short time window available. CS shareholders will be compensated with UBS shares (share swap): They will receive one UBS share for every 22.48 CS shares held. This equates to a takeover price of 76 centimes per CS share – or a discount of more than 50% – based on the CS closing price as at 17.03.2023.

Subordinated bonds now valueless

The AT-1 convertible bonds of CS – with a nominal value of CHF 16 billion – will not be redeemed, hence any holders of these instruments will suffer a total loss. These lower-ranking bonds form part of so-called Tier 1 capital on the bank's balance sheet. This loss will no doubt trigger plenty of debate, and the wider market for these investments – which have a global value of USD 275 billion – is likely to be volatile in the short term as the market reappraises the risks of such instruments.

Substantial guarantees

UBS can fall back on Swiss government guarantees amounting to more than CHF 9 billion. These would kick if the takeover of CS were to result in specific loss events. To a certain extent, these guarantees mitigate the risks assumed by UBS with this takeover. Moreover, in addition to the usual emergency liquidity, the SNB is providing both CS and UBS with extraordinary, comprehensive liquidity assistance totalling CHF 200 billion. The takeover does not require the approval of either UBS or CS shareholders at any general meeting. Shareholder rights were excluded through the invocation of emergency law.

UBS stock in vogue (for now) after brief dip

UBS has confirmed its strategic focus. This is predominantly on the wealth management business rather than investment banking, with Asia and North America identified as growth markets. Significant headcount reductions can be expected in Switzerland due to the overlap in business activity. Whether or not CS will be integrated in its entirety or split up into different entities is not yet clear. Although UBS stock came under heavy pressure in early trading on Monday, it recovered significantly as the day went on. We expect the stock to remain volatile until there is greater visibility with regard to the risks and opportunities of the takeover.

Wir begleiten Sie im Leben.

Financial crisis 2.0?

The takeover of CS by UBS represents another spike in the ongoing weakness of confidence in the banks. Only last week the collapse of Silicon Valley Bank (SVB) in California prompted the US central bank (Fed) to activate support measures (provision of liquidity). Given these developments, many observers have been quick to predict a new financial crisis echoing that of 2008/2009. By contrast, we perceive the risk of a systemic crisis to be low – as long as a confidence crisis can be warded off.

The challenge faced by central banks

The crisis involving SVB, regional banks in the US, and CS has prompted market participants to re-evaluate the Fed's interest rate policy. Interest rate expectations have been reined in significantly, and the markets are now expecting central bank policies to become more restrained. However, we believe it is too early to anticipate a change in the course of these policies. Inflationary pressures have yet to be brought under control. Only last week the European Central Bank (ECB) tightened the monetary policy screws further, despite turbulence in the banking sector.

The twin pillars: bonds and equities

Sooner or later, the ongoing cycle of interest rate increases and the above-mentioned uncertainties in the banking sector should have an impact on economic growth. Will this lead to lower equity prices? Not necessarily, because in the event of inflation rates declining, hopes of lower key interest rates will lend support to equity markets. This tense situation is reflected in persistent market volatility. Given this backdrop, we consider bonds to be more attractive than equities in the short term.

Adopt appropriate positioning

As things stand, we believe a balanced mix of asset classes with a stronger focus on bonds is the way forward. However, equities should clearly remain a crucial component of any portfolio for strategic reasons.

Focus remains on quality stocks

Many high-quality Swiss companies have demonstrated their strength once again with their annual results. Thanks to the high quality of their business models, they were able to exploit their price-setting power, generate attractive cash flows, and impress the investor community. Swiss equities retain their high weighting, accounting for a third of the entire equity allocation. Switzerland's defensive sectoral mix is an advantage in the current environment, which is shrouded in uncertainty.

What does this mean for investors?

The bandwidth of possible developments going forward remains wide. As long as the current economic slowdown does not gain further momentum, greater equity exposure looks appealing. However, if inflationary risks were to rise further, equity investments can be expected to remain under pressure.

When it comes to investment policy, two aspects come to the fore: Firstly, it makes sense to adopt a positioning close to the strategic asset allocation so that any changes can be responded to rapidly and flexibly. Secondly, investors should firmly adhere to their investment strategies in such situations.