Subordinated debt
Monthly commentary

PROMOTIONAL DOCUMENT

September 2022

1/ Market environment

It has been quite a turbulent autumn and the subordinated debt markets have come under increasing pressure as fears of high inflation and global recession continue to grow. Indeed, the month was strongly affected by a very hawkish tone from global central banks, leading to increased volatility in sovereign rates. Firstly, the European Central Bank announced a 75bp interest rate hike, bringing its benchmark deposit rate to 0.75% and revised its inflation expectations upwards to an average of 8.1% in 2022. The FED raised rates by 75bps and announced that it expects a further tightening of 1.25% before the end of the year and reduced its growth forecasts. The biggest surprise came from the Bank of England, which decided to raise rates by 50bps, but more importantly from the UK government, which proposed a radical £161bn fiscal stimulus package, including tax cuts, a corporate tax freeze and a subsidy for energy bills. These steps taken by the UK government have led to increased volatility in the Gilt (with variations of 100bps on one day for the 30-year Gilt, for example). The focus this month has again been on the macroeconomics that drive all global markets. Over the month of September, the AT1 CoCos € debt index posted a negative performance of -7.29%. Its equivalent in dollars is much the same, with a performance of -5.52% over August. The other subordinated debt classes also ended the month in negative territory: The iBoxx Tier 2 debt index fell by 3.62%, the iBoxx Subordinated Insurance Debt index by 5.50% and the iBoxx Corporate Hybrids by 4.02%.

The primary market was active at the beginning of the month and fell silent as volatility increased. In the Tier 2 market, Raiffeisen Bank International issued a €500m Tier 2 with a coupon of 7.375% (10.25NC5.25). Nykredit also issued a Tier 2 of €500m with a coupon of 5.5%. For its part, BPER Banca launched a Tier 2 of €400m with a coupon of 8.625%. On the Insurers' side, Coface announced the launch of a Tier 2 bullet 2032 with a coupon of 6%. After a long silence on the Corporate Hybrids market, two issuers have returned to the market. Indeed, Telia (a Swedish telecoms company) reopened the market with a €600m hybrid at 4.65% (60.25NC5.25). In addition, KPN (a Dutch telecom operator) issued a €500m green hybrid with a Perpetual Non-Call 5.25 structure with a coupon of 6%. At the same time, the month of August was once again marked by the theme of calls and non-calls on AT1s and Tier 2 bank debt. Bank of Nova Scotia (Canadian bank) decided not to exercise the call on its $AT1 4.65% (US064159KJ44). This is the second AT1 extension this year after Aareal Bank did not recall its AT1 for the third time (the bond is redeemable every year). On the Tier 2 side, Banco BPM recalled its €500m bond with a coupon of 4.375% on the last day of the call window.

September was an eventful month for Credit Suisse. First, the Financial Times reported on a possible split of their business into three parts – the group's advisory assets, a "bad bank" to be wound up, and the rest of the business. In addition, Reuters reported that the bank had canvassed investors for a possible capital increase and suggested that Credit Suisse was considering leaving the US market, which the bank "categorically denied". Credit Suisse issued a statement and said the bank was "on track with its comprehensive strategic review, including potential divestments and asset sales". This was without counting the outpouring of rumours about the bank's financial health on Twitter at the end of the month. Indeed, there has been a lot of speculation following the movements in CDS spreads (despite the fact that Credit Suisse is trading at the same level as the Italian banks) and the share valuation (remember: bank stock valuations are a very poor indicator of potential bankruptcy).

The CEO responded by reassuring employees and investors that its capital and liquidity position was sound and that its share price movements did not reflect the financial health of the bank. Indeed, despite recent poor results, Credit Suisse remains well capitalised (CET1 of 13.5% in Q2 2022) and has abundant liquidity (CHF 235bn of high-quality liquid assets). However, stocks and bonds reacted quite violently on 3 October 2022. This reminds us of the rumours surrounding Société Générale in 2012 or Deutsche Bank in 2016. This could trigger larger and earlier restructuring announcements than expected, possibly accompanied by a capital increase. The bank will announce its strategy alongside its result for Q3 2022 on 27 October. We have not had any position in Credit Suisse in our subordinated debt funds since 31 August 2021.

On the non-financial side, EDF has announced that its 2023 targets will be subject to review once the terms of regulation for next year are specified. This announcement follows the speech made by the Prime Minister, Elisabeth Borne, on the extension of the tariff shield for 2023 with a cap on the increase in regulated electricity tariffs at +15% from next February. The French energy company announced in a press release that the losses linked to the drop in its production (corrosion, maintenance operations) would likely be even greater than expected. Indeed, EDF has indicated that based on the information available to it, the estimated impact of the drop in production on the group's EBITDA for 2022 has been re-assessed at around -29 billion euros compared to the previous estimate of -24 billion euros.

Main associated risks of subordinated debt funds: Risk of capital loss, interest rate risk, ESG investment risk, credit risk, risk arising from techniques such as derivatives, counterparty risk, risk associated with holding convertible bonds, risk related to contingent convertibles, equity market risk, potential risk of a conflict of interests, legal risk prospectus, the Key Investor Information Document and the annual and semi-annual reports, which contain all the necessary information about the product including the costs and risks, are available free of charge upon request to La Française AM, 128 boulevard Raspail, 75006 Paris - France: contact-valeursmobilieres@la-française.com, at www.la-francaise.com or from:

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