

Investment Playbook Weekly Update

May 5, 2023

**LIGHTHOUSE
CANTON**



OUTSTANDING DIGITAL
TRANSFORMATION IN COVID
19 BY A FAMILY OFFICE

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UNITED ARAB EMIRATES

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Weekly Spotlight

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Bond Spotlight: Julius Baer 4.75 Perp

Bond Details

ISIN	XS1679216801
Issuer	JLIUS BAER GROUP LT
Country	CH
Sector	Financial
Rank	Jr Subordinated
Currency	USD
Outstanding	300,000,000
Maturity Date	N.A.
Mty Type	PERP/CALL
Next call Dte	9/12/2024
Next call Px	100.00
Mod. Duration	1.3
Yield to Worst (Ask)	18.4%
Price (Ask)	84.4

Key Ratios (banks)

Common Equity / Total Assets	6.0%
Non-Perf Assets / Total Assets	0.17%
Tier 1 Common Equity	14.0%
Total Capital Ratio	21.7%
Common Equity / RWA	17.3%
Return On Equity	14.6%

Bond Price



Rating (Bond)

Moody's	Baa3
S&P	N.A.
Fitch	N.A.

Default Risk

CDS (%)	0.6%
Altman ZS	N.A.

Source: Bloomberg

Date: 04/05/23

Bond Spotlight: Investment Rationale

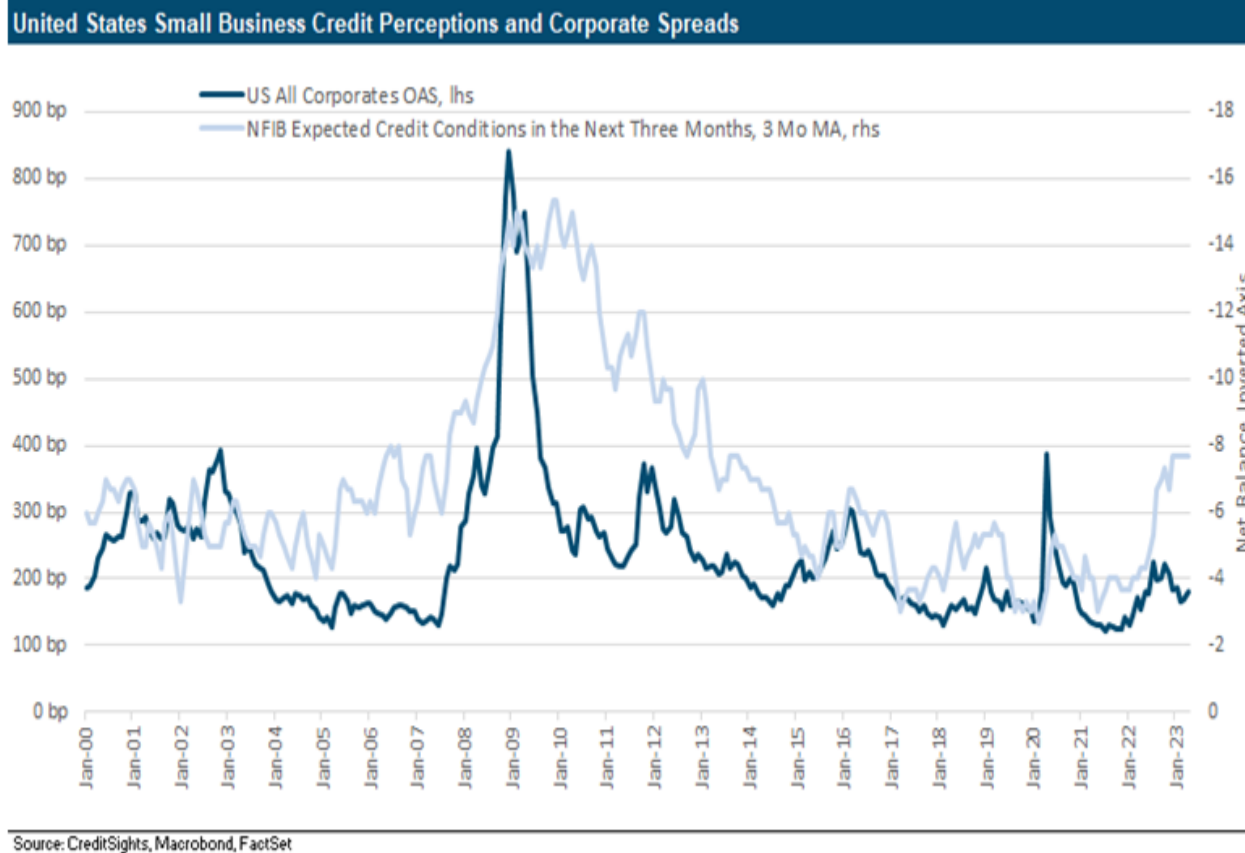
- **Company Description** : Julius Bär Group AG is a private banking corporation founded in Switzerland. Headquartered in Zurich, it is among the older Swiss banking institutions. In terms of assets under management, Julius Baer is number two among Swiss banks after UBS and the biggest pure-play private bank.
- **Investment Rationale** : The junior subordinated bond (AT1 coco) with a permanent write off feature is currently trading at 84 cents, offering a highly attractive yield of 18.4% if called in September 2024. This bond is similar to the ones written off by the Swiss regulator in the Credit Suisse case. However, there are several reasons why we believe this particular bond is an excellent opportunity.
 - Firstly, unlike Credit Suisse, Julius Baer is a rock-solid bank that only focuses on private banking, which makes it highly profitable. Its balance sheet has benefited from the collapse of Credit Suisse, gaining market share, and its shares are trading at historical high levels, which shows its stability compared to its peers.
 - Secondly, Julius Baer has a Total Capital Ratio of 21.7%, a Return On Equity of 14.6%, and a Common Equity to Total Asset ratio of 6.0%, making it one of the most robust banks currently available. We believe the probability of Julius Baer facing the same issues as Credit Suisse is close to 0%.
 - Lastly, we anticipate the bank will call this bond in September 2024 to avoid any reputational risk. Therefore, we see the 18% yield to call as a highly attractive opportunity for any growth-oriented investor.

Charts of the week

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Credit Perception & Spreads

NFIB small businesses' concerns on near term credit access.

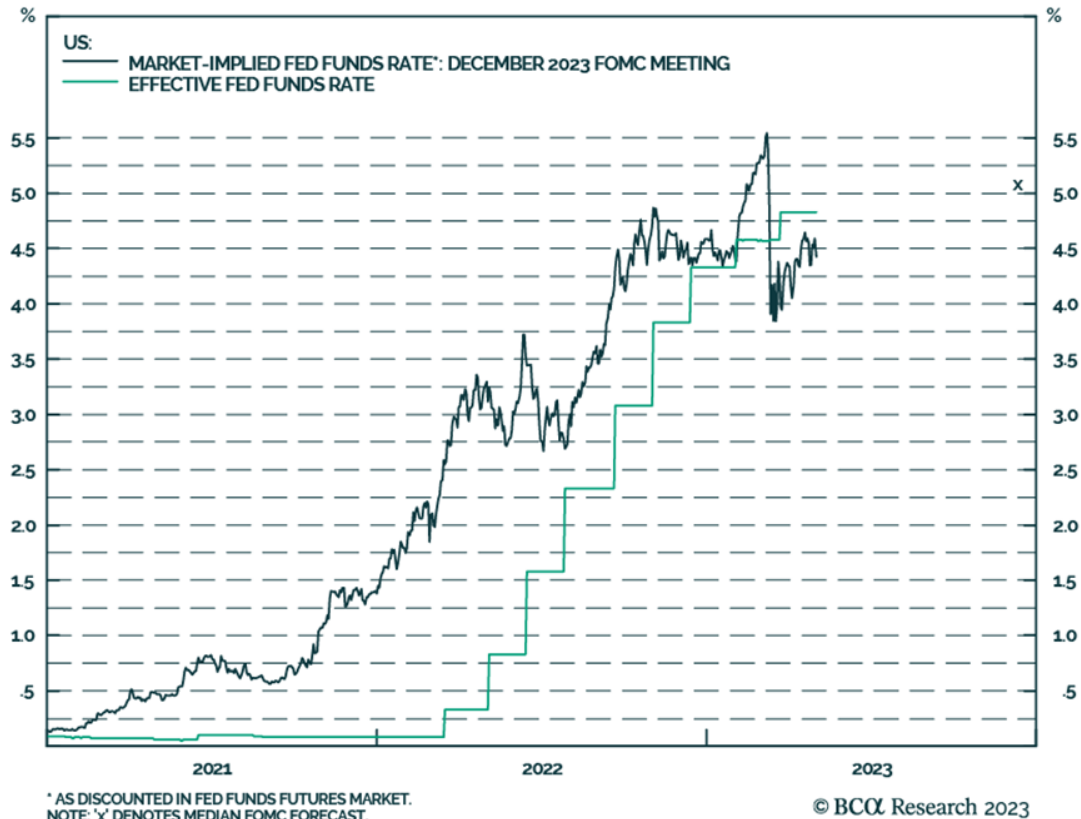


- Though spreads across corporate credits have tightened since the recent peak, Fed's aggressive tightening and recent banking sector crisis most likely has deteriorated credit access
- Concerns from small business about near term credit access is likely to hit the US economy hard.

Source: CreditSights , May 2023

Pause?

Rates likely to remain high for the remainder of the year

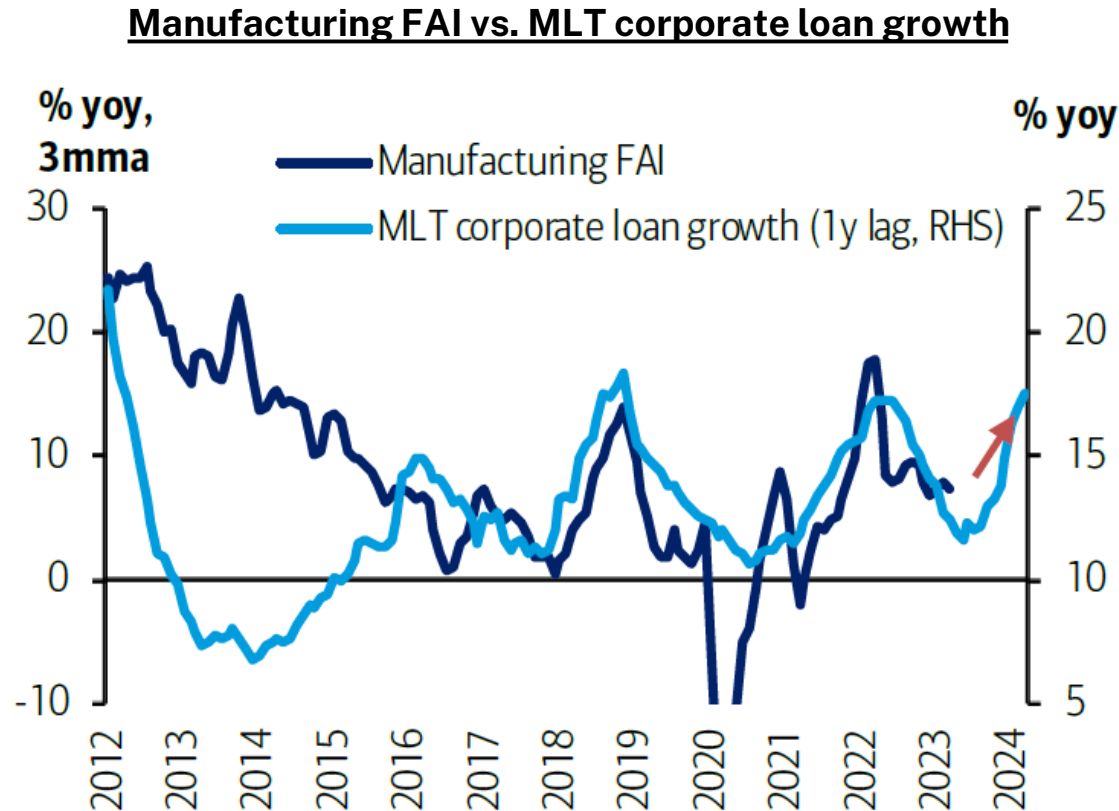


Source: BCA Research, May 2023

- The Federal Reserve increased interest rates by 25 basis points but signaled that this may be the end of the tightening cycle.
- The statement indicating the need for additional policy firming was removed. Powell revealed that pausing at the next meeting was discussed, and the Fed has been focused on the economic implications of credit tightening.
- However, if inflation remains sticky, rate cuts will not be appropriate in H2.

China is likely in the beginning of a new credit cycle

Medium Term Loan (MLT) growth trends suggests more manufacturing capex ahead



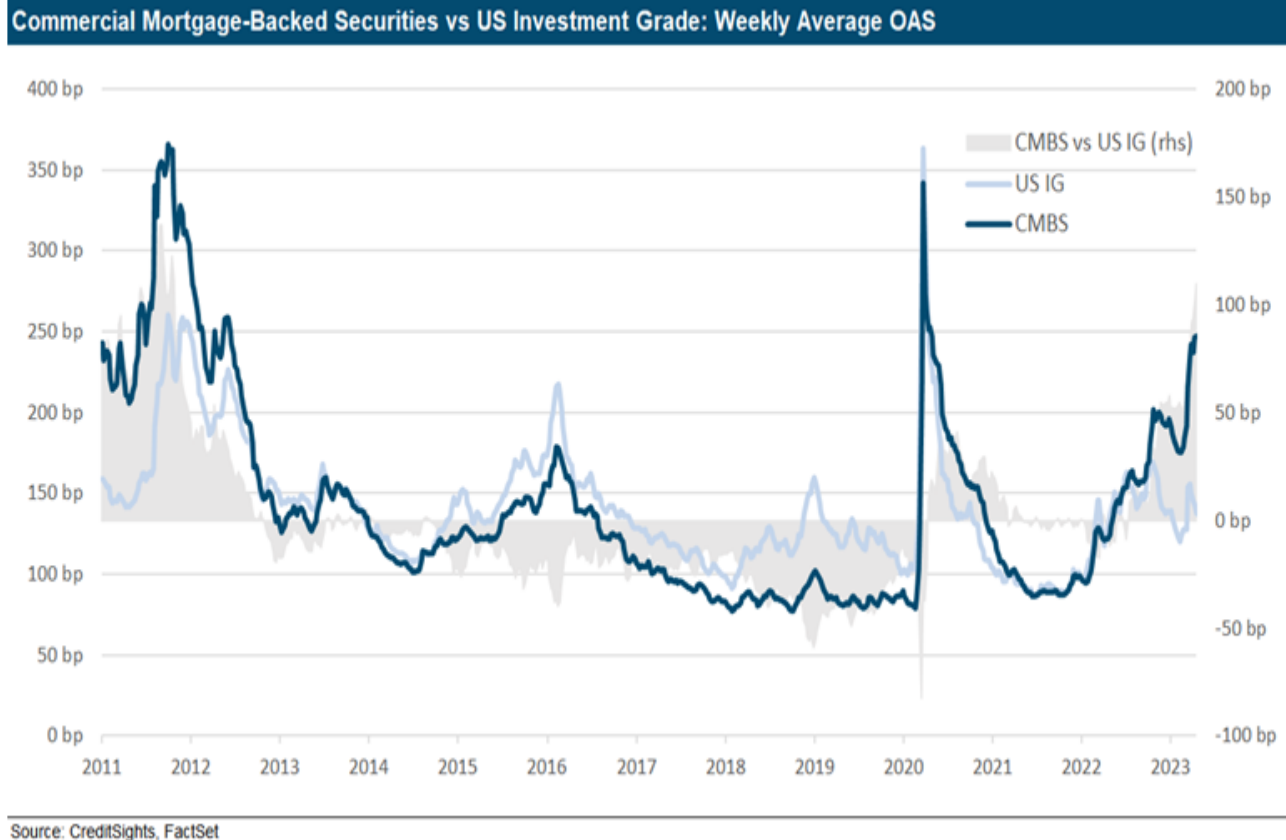
Source: BofA Global Research, CEIC

Source: CBOE, Bloomberg, Apr 2023

- Current MLT growth trends have been driven by favorably policy support on infrastructure and manufacturing investments, as well as falling policy rates.
- As MLT growth typically lags manufacturing Fixed Asset Investments (FAI) by 12 months, the current MLT trend suggests a probable uptick in FAI growth in the coming quarters
- Higher FAI coupled with continued strength in consumption (driven by pick up in consumer confidence, income growth and excess household savings), should help boost overall economic liquidity in China which are supportive for Chinese risk assets relative to DMs.

US CMBS - Signs of Stress

Commercial Mortgage-Backed Securities trade at the widest since COVID peak

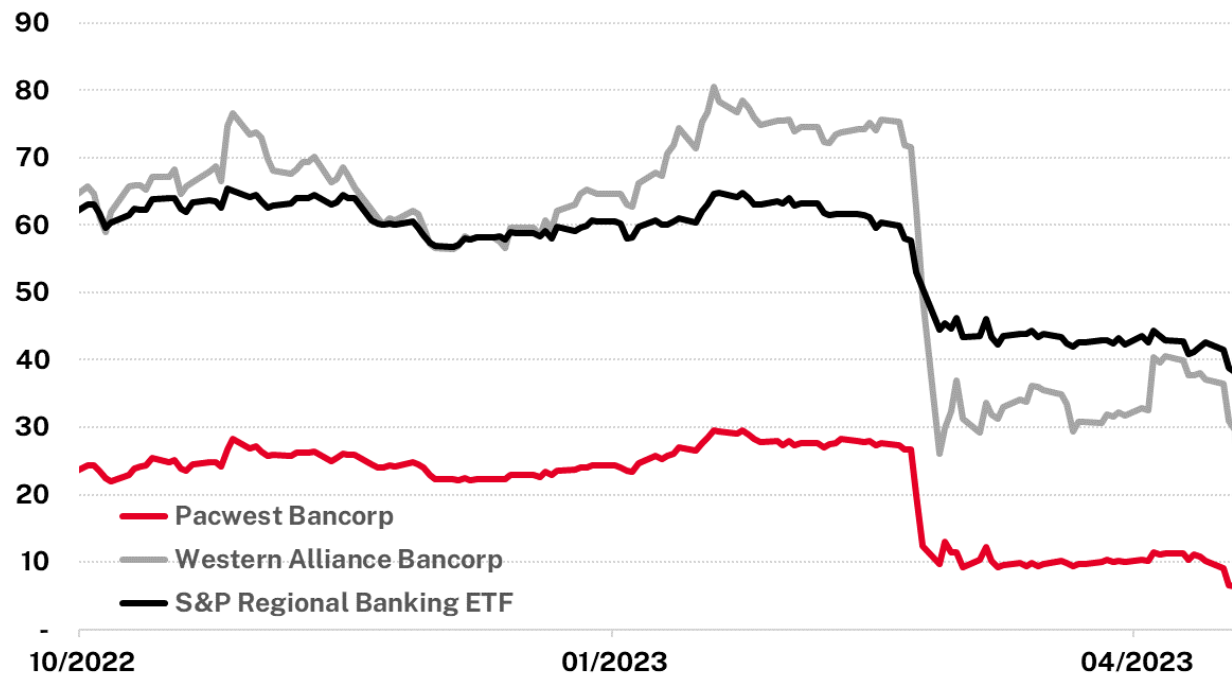


Source: CreditSights, Apr 2023

- CMBS OAS has been trading the widest relative to US IG since June 2022. It trades at 107 bps wider. Post GFC and excluding COVID, CMBS has traded tight to US IG with a **long term median monthly spread difference of -11 bps**.
- This signifies the enhanced stress higher rates have caused and serves as a warning to remove strategies focused on CMBS from portfolios (e.g., PIMCO GIS Income fund)
- Since 2007, the CMBS index has declined by 25% in market value compared to an increase of 273% by the US IG Index during the same period.

US Banking crisis continues to unfold

Yet another bank fails less than a month after the SVB failure



Source: CreditSights, Apr 2023

- J.P. Morgan acquired most of the assets and liabilities on the books of First Republic Bank on Monday, after it was taken into receivership by the FDIC, marking the 3rd major US bank to fail in less than 2 months.
- While Fed Chair J. Powell saw the takeover of First Republic as having drawn a line to this banking crisis, 2 more US banks seem to be teetering on the edge of going down.
- Reports emerged on Wednesday post market, that both Pacwest Bancorp and Western Alliance Bancorp are exploring 'strategic options' which caused their shares to fall by 50% and 38% respectively.

LC Views - Summary

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LC Views Summary (1/2)

Sub-Asset	Recommended Positioning
Rates	<ul style="list-style-type: none">Post May FOMC, the Fed had hiked by 25bps as widely anticipated. It also signaled a pause, citing that policy will be more data dependent. Meanwhile bank lending standards have tightened further on back of banking stresses, with headline CPI at 5.1% and core CPI at 5.6% nowhere near the Fed's long-term average of 2%. The Fed will likely be challenged with balancing inflationary risks and containing any further deterioration to financial stability. That being said, we feel policy rates have likely peaked and markets are expecting cuts to start materializing early next year – this makes longer duration positioning more favorable.
Credit	<ul style="list-style-type: none">We continue to favor investment grade bonds to build a strong foundation for the portfolio and seek to compliment the latter with selective high yield bonds for yield enhancement. While we recommend to allocate a larger portion of the portfolio in short duration bonds due to the elevated yields, we are actively seeking to extend duration into the 7-10Y space as opportunities arise. Due to the challenging economic outlook ahead, we see further opportunity in special situations bond funds, which provide absolute portfolio returns with no correlation to the overall economic cycle.
Equities	<ul style="list-style-type: none">The benchmark S&P 500 rose 7% in the first quarter after dropping nearly 20% in 2022, while gains across technology stocks have pushed the Nasdaq 100 up 20% since the start of January. Equity valuations do not appear compelling once adjusted for the shortfall in corporate earnings, and equities do not seem attractive relative to bonds when using a 3-year Z-score Bond-Yield to Earnings-Yield ratio. 408 members of the S&P 500 have reported earnings till now and on a consolidated basis they have reported a 3% drop in earnings and modest 3.7% growth in sales. We expect earnings to continue deteriorating on the back of tighter credit conditions as the US banking crisis continues to unfold and contrary to the consensus estimates, do not expect a strong rebound in earnings in the back half of the year. Consequently, we maintain our bearish outlook on equities for the next six months and recommend (in order of preference) Long/Short managers, options (FCNs or Puts), and quality stocks.

LC Views Summary (2/2)

Sub-Asset	Recommended Positioning
Currencies	<ul style="list-style-type: none">• Currencies are expected to remain volatile throughout 2023. Given higher recessionary risks, the USD may strengthen over a short-term tactical horizon but for longer term investors, we continue to hold the view for a bearish USD. Exposure to JPY, EUR and GBP could be increased over time to benefit from the recent lows and a peak in dollar's strength driven by peak policy rates. We also recommend adding active managers (Macro funds) to monetize opportunities in currencies and rates.
Commodities	<ul style="list-style-type: none">• Our long-term view for a bearish USD is likely to be supportive for Gold. We also like the yellow metal for structural reasons: diversification benefit, inflation hedge, geopolitical risk and de-dollarization trend.• Oil is likely to remain highly speculative this year as witnessed in March. On one hand, recessionary fears should temper demand. On the other hand, the production cut by OPEC+ members will inevitably support prices in the mid-term.
Real Estate	<ul style="list-style-type: none">• Tightening financial conditions have started to cause sharp repricing in property prices globally and threaten rental growth rates. The risk of further correction in real estate prices should not be underestimated. There will be opportunities to pick good REITs cheaper next year.• With the recent banking turmoil, Commercial Real Estate exposure is increasingly at risk given the large exposures the smaller banks have to the sub-sector. Clients holding on to any related exposures should consider removing them.

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