

## Credit Notes: The aftermath of a deal

Today, UBS announced it is to acquire Credit Suisse in an all-share transaction valued at \$3.25 billion. The deal also includes support from the Swiss federal government, the Swiss Financial Market Supervisory Authority (FINMA), and the Swiss National Bank (SNB). The SNB will offer a liquidity line of CHF100 billion that is backed by a federal default guarantee while the Swiss federal government will also provide a loss guarantee of up to CHF9 billion, with UBS bearing the first CHF5 billion of potential losses. More details will likely emerge over the next few days, but today's deal provides investors with enough clarity over direct and indirect exposures to Credit Suisse. For credit markets, the read-through is twofold:

- In both the USD and EUR markets, the excess premium that investors had been demanding to hold European bank credit risk now has room to compress (Exhibit 1). On Friday, we argued that the performance of the broader European banking sector would remain pressured until clarity is provided on Credit Suisse's future path and recommended moving to a neutral allocation on banks in the EUR market (from overweight previously). Today's outcome provides such clarity. In particular, the liquidity and loss guarantees provided by the SNB and the Swiss government are likely to act as dampeners for tail risk and help close the recent valuation gap between European banks and non-financials. As such, we don't think a neutral allocation is warranted and are shifting back to an overweight allocation. Of course, we are mindful that the situation among US regional banks remains fluid. But as we discussed on Friday, we take comfort from the limited contagion from US regional banks to larger money center banks, a trend we expect will persist. We reiterate our overweight allocation on US money center banks in the USD market.

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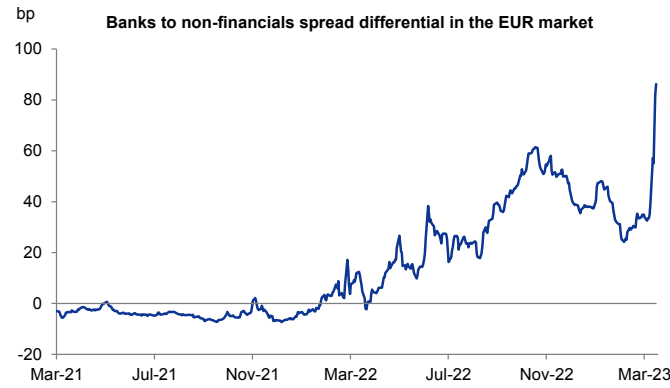
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**Exhibit 1: We expect the underperformance of banks in the EUR market will reverse**

Spread differential between banks and non-financials in the EUR IG market



Source: iBoxx, Goldman Sachs Global Investment Research

- Sentiment vis-à-vis the AT1 bond asset class will likely remain weak following today’s deal. The UBS takeover will trigger a complete write-down of Credit Suisse’s USD-denominated AT1 bonds, a move that can be interpreted as an effective subordination of AT1 bondholders to shareholders. It also represents the largest loss ever inflicted to AT1 investors since the birth of the asset class post-global financial crisis. On Friday, we argued that the material widening in EUR AT1 bond spreads relative to HY bonds was a dislocation that presents an opportunity to add risk (Exhibit 2). Today’s decision to write down AT1 bonds while preserving some shareholder value greatly weakens the case to add risk. Whether investors treat this decision as a one-off or whether they rethink the asymmetry of their risk-reward at times of elevated financial distress remains to be seen. But in our view, it has become harder to assess the attractiveness of the current historically large spread pick-up provided by AT1 bonds vs. their HY corporate counterparts, which will likely constrain the appetite towards the AT1 asset class.

**Exhibit 2: Despite a large spread pick-up vs. HY bonds, the appetite towards AT1 bonds will likely remain constrained**

Spread differential between EUR AT1 bonds and HY bonds



Source: iBoxx, Goldman Sachs Global Investment Research

# Disclosure Appendix

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