STATE STREET GLOBAL ADVISORS

A valuable lesson on liquidity and capital preservation

Volatility continued at the start of 2023, as markets reacted to regional bank defaults in the United States, and a forced takeover of a Globally Systemic Important Bank in Europe. Despite the global uncertainty, floating-rate senior-unsecured AUD bank debt liquidity remained high, and performance was positive during the first quarter.

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Head of Australian Cash and Bonds

Developed market bank debt defaults, aggressive monetary policy tightening cycles implemented by global central banks and heightened risk on / risk off market sentiment, all describe the first three months of 2023. Against this backdrop, liquidity profiles and performance returns were substantially different between categories of bank debt issuance. As noted above, there were a number of defaults in USD regional bank exposures during the quarter. In addition, a bank merger in Switzerland triggered a default in contingent convertible (coco) debt issuance, otherwise known as alternate tier one (AT1) capital.

When bank defaults occur on both sides of the Atlantic, markets become instantly concerned about the real potential of a global banking crisis, or to a lesser extent, prolonged banking stress that could potentially break other banks. This market sentiment helped drive increased price volatility and reduced liquidity in lower ranking styles of debt such as hybrids, subordinated (sub), extendable, coco's and even debt with a weighted average life (WAL) rather than a bullet/legal maturity. Many market participants argue liquidity of debt assets needs to be at the forefront of investor minds, during volatile times like global markets just went through.

Floating-rate senior-unsecured bank debt continued to trade very well during Q1 and delivered positive returns for the quarter. Despite increased volatility in credit spreads, particularly in mid-March when perceived bank stress was at its most heightened, senior-unsecured bank spreads from 1 January 2023 to 31 March 2023 actually compressed! Owning floating-rate senior- unsecured AUD bank debt during the quarter, proved to be a strong investment compared to other fixed income assets. The portfolio both bought and sold bonds during the quarter. Primary issuance was absorbed by the market with bid-to-cover ratios well above 1:1. Pricing in AUD senior unsecured bullet maturities, although wider in bid/offer was still sharp and liquid. We don't buy hybrids, sub debt or coco's in our portfolio – a decision we are very comfortable with given the recent troubles.

Important Disclosures

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