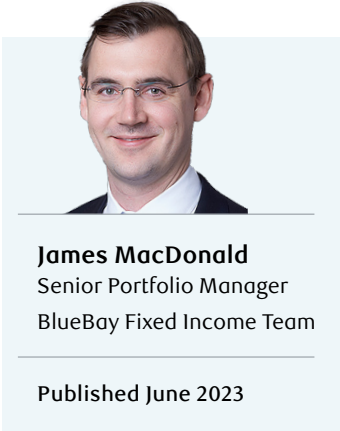




# AT1 recovery and why fundamentals win over time

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**“Most bank management teams realise that investors want predictable behaviour.”**

Investment grade specialist James MacDonald, BlueBay Senior Portfolio Manager, discusses how the AT1 market has progressed since the turmoil in March and what is next.

## The ‘call economics’ of the AT1 market

With close to EUR10 billion worth of Additional Tier 1 (AT1) bonds with call dates over the remainder of 2023 (since the Credit Suisse debacle), many investors are questioning whether issuing banks will choose not to exercise their calls. We believe most issuers will. This is the behaviour we have seen this year, with calls being exercised even at times of elevated spreads.

Most bank management teams realise that investors want predictable behaviour, and they will be rewarded for this through tighter credit spreads across the cycle and through time. When management teams think about ‘call economics’, the vast majority realise that it is short-sighted to think about this on a bond-by-bond basis at a particular point in time. Further to this, we see the sector as carrying significant levels of excess capital, and this gives issuers the flexibility to call bonds and wait for more opportune market conditions to reissue, rather than to be hostage to particular periods of market volatility.



### **AT1 remains an important part of a bank's capital structure**

It remains attractive for banks to issue AT1 bonds as an alternative to equity despite the elevated spread levels. And while most banks have the capital flexibility to afford to be patient to an extent, we do not think this will keep them away from markets for a sustained period. On the other side, there remains significant investor demand for the asset class. European bank fundamentals are in robust shape, and this has been underpinned by record results in Q1. We would expect at current levels that new issuance would be very well received by the market, and this demand could be a catalyst for the market repricing to tighter levels and continue to recover some of the ground lost in the first quarter of the year.

**“Our strategy is broadly unchanged. European bank fundamentals remain extremely robust. We always believe that over time fundamentals will always reassert themselves and be efficiently priced by the market.”**

### **The AT1 market recovery**

In the short term, the secondary market seems to have absorbed the shock, even bidding up prices of AT1 subordinated debt. We have continued to see the market recovering since the shock of March and this has been against the headwinds of further issues with US regional banks, debate over the US debt ceiling and ongoing macroeconomic volatility. As these issues are worked through, we expect this will give the asset class the breathing space to recover further. While AT1 saw a setback in Q1, we believe that the risk-reward potential of the asset class remains incredibly attractive and an opportunity that investors will continue to take advantage of, over this year.

### **Fundamentals win over time**

The start of the year was extremely optimistic for AT1 debt. However, pressures in the US regional banks and the shock of the Credit Suisse wipeout have had a very indiscriminate impact on the markets, but we do not believe this is a dynamic that will persist. As such, our strategy is broadly unchanged. European bank fundamentals remain extremely robust. We always believe that over time fundamentals will always reassert themselves and be efficiently priced by the market.

We continue to look towards high-quality banks with clear strategies and strong fundamentals and expect with spread levels where they are that over the year the AT1 market presents an extremely attractive risk-return opportunity.



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