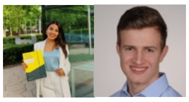
ASSETS AMSA

Monday 13th November 2023

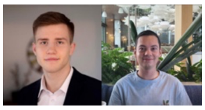
Weekly Newsletter



Ransomware attack on ICBC disrupts trades in US Treasury market

A ransomware attack, that targeted the financial services arm of the Industrial and Commercial Bank of China (ICBC) has caused a disruption in the US treasury market, as market participants were forced to reroute trades. While the attack did not impair the market's overall functioning, some effects on the liquidity of the US treasuries were noticeable. The yields on the 30-year bonds rose sharply on the Thursday afternoon auction for instance. While the connection between the two events cannot fully be made, the crunch in liquidity on the treasury market was likely, said an executive at a large market clearer for US Treasuries.

The attack was first detected on Wednesday and has been immediately addressed by the information security experts at the ICBC. The number of ransomware attacks has been growing quickly following the remote working rush during and after the coronavirus pandemic, and large companies have been the target of several successful attacks in the past already, with increasing tendencies. In 2021 alone, several attacks were directed at Multinationals such as Brenntag, AXA and Acer, all ending with paid ransom by the companies. The ICBC has reportedly notified law enforcement of the industry and has successfully contained the incident by disconnecting and isolating affected systems. However, in the upcoming days, treasury markets might continue to face small liquidity crunches as BNY Mellon, the world's largest custodian bank, has disconnected ICBC from its services electronically, causing delays in trade settlements. As ICBC is the only Chinese broker with a securities clearing license in the US, the issue might have more extensive effects as previously suspected.

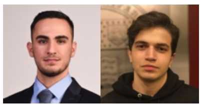


Unprecedented cash outflow from Middle East ETFs

In response to escalating unrest in the Middle East, foreign investors withdrew a historic amount from U.S. equity funds tied to Saudi Arabia in October. The iShares MSCI Saudi Arabia ETF experienced an unprecedented outflow, losing over $200 million, equivalent to a 20% decline from the month's beginning. Simultaneously, concerns about regional instability created outflows from ETFs linked to Qatar, the UAE, and Israel. Analysts observed that this capital flight seemed more influenced by a perceived rise in overall regional risks than specific fundamentals of each country, leading to investors demanding a premium for the risk. Notably, ETF outflows from Gulf countries outpaced those from most emerging markets during this period.

Despite facing these challenges, regional ETFs displayed resilience, rebounding from losses incurred after the attack by Hamas on October 7th. Nonetheless, the cash outflow from ETFs signals a dent in the confidence of investors, even as broader markets exhibit resilience. While Israel and the Gulf states have robust economies supported by significant resource reserves and surging oil prices, the equity investor cash outflow underscores persistent risks and challenges to diversification efforts amid ongoing regional conflict.

The economic uncertainties extend beyond immediate concerns, as the length and consequences of the conflict could pose future challenges. Continued conflict may impede Saudi Arabia's efforts to reduce reliance on oil, while the aftermath could have enduring effects on Israel's economy, disrupting businesses and investments. These uncertainties underscore the need for a cautious approach in navigating the intricate dynamics of the region and raise questions about the future trajectories of the affected economies.



Powell's Remarks: Impact on US Dollar and Inflation Sentiments

The US dollar fell on Friday, while global stock markets recovered, mainly due to the ease from initial concerns about potential interest rate hikes following Federal Reserve Chair Jerome Powell's comments that tighter monetary policy measures may be needed to control inflation.

Powell's comments, which initially caused nervousness in the markets, were later tempered by hints of a weaker labour market and expectations that the upcoming Consumer Price Index (CPI) report could show a slowdown in inflation.

Michael James, Managing Director of Equity Trading at Wedbush Securities, noted a significant shift in market sentiment last week. Investors seemed less convinced that the Federal Reserve would promptly raise interest rates. The prevailing sentiment among investors suggested that US interest rates may have reached their peak, particularly following the Federal Reserve's decision to leave its overnight rate unchanged the previous week.

Thierry Wizman, Global FX and Interest Rates Strategist at Macquarie in New York pointed to the potential impact of falling gasoline prices on the upcoming CPI data. In his opinion, lower CPI figures could lead to lower yields and a subsequent softening of the US dollar.

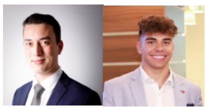
While a 0.3% month-on-month rise in the core CPI for October was predicted, matching September's figures and forecasting a 4.1% year-on-year increase, US consumer sentiment fell for the fourth consecutive month in November. According to preliminary results released Friday by the University of Michigan, households expressed increased caution about the economy and their price expectations reached their highest level in more than a dozen years.

Decade-high commercial real estate loans

Past-due commercial real estate loans in the United States have surged to a 10-year high, reaching their highest level due to a combination of factors including higher interest rates, economic uncertainty, and the widespread adoption of remote work. This blender of economic uncertainty increased investors' concerns on the commercial real estate sector (CRE) as the industry is facing trillions of dollars of maturing debt.

Non-owner occupiers, particularly in the office sector, witnessed a significant 30% increase in past-due loans, totalling $17.7 billion in the third quarter—a $4 billion jump from the previous quarter and a $10 billion increase over the year. Although the current past-due rate stands at 1.5% of commercial property loans, industry experts anticipate continued pressure on property owners, particularly in the office space segment. The recent bankruptcy filing by the giant desk rental company, WeWork is expected to exacerbate the situation, putting additional strain on building owners and lenders.

Wells Fargo, the US's largest lender in commercial real estate with over $70 billion in outstanding loans, reported a staggering 50% increase in past-due property loans to $3.4 billion in the third quarter, up from just $400 million a year ago. Despite the growing delinquencies, banks like Wells Fargo have been cautious about declaring actual losses, expressing optimism that many borrowers will resume payments. Industry analysts, however, predict an increase in delinquency rates for at least the next 12 months, with anticipated challenges, though a gradual transition from delinquencies to actual losses. Some banks, including Bank of America, are proactively restructuring property loans to mitigate losses, contributing to an industry-wide rise in restructured commercial real estate loans, which now total $8.5 billion in the past six months.

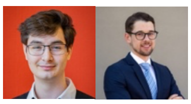


SEC faces fierce pushback on plan to police AI investment advice

AI adoption has been increasing since December 2022 with the public release of ChatGPT. However, as one of the memorable lines from the movie 'Margin Call' implies 'It sure is a hell of a lot easier to just be first'. AI adoption in finance isn't novel and corporations and investment banks have long been using it together with machine learning, outpacing the new coming late adopters in efficiency and data-driven decision-making.

To put this into perspective, across industries, McKinsey estimates AI could add $200-340 billion in value to the finance sector alone, optimizing processes in functions such as risk and legal, customer operations and software engineering. However, 'where is light, there is also shadow' and recent advances in the technology surpass regulatory and societal adaptation. That is why the SEC chair Gary Gensler proposed July regulations to govern AI use in financial markets, from investment advice to sector-wide forecasts based on predictive models. Last week, President Biden's executive order consolidated oversight across 25 agencies, emphasizing the urgency for adequate regulation in overseeing the fast-developing technology, establishing the US as the global leader in regulating AI. There has been a huge pushback following the announcement from brokers, hedge funds and investment advisers. Moreover, Sifma (Securities Industry and Financial Markets Association) calls for the dropping of the new regulation because it represents rulemaking in an unfair and unpredictable way. The association's worries were backed with individual letters from banking giants such as JPMorgan and Morgan Stanley.

The crux lies in the balance: while regulation is vital to avert a market collapse due to overreliance on AI models, it's crucial to acknowledge the technology's immense benefits for businesses. As the financial landscape navigates this intricate interplay between innovation and regulation, finding this equilibrium is essential and only time will tell how this will play out.



WeWork declares bankruptcy, falling from its $47 billion valuation in 2019.

WeWork, once valued at $47 billion in 2019, filed for bankruptcy, marking a dramatic fall from grace. By 2023, its valuation had plummeted to just $45 million, with its stock losing over 98% of its value. WeWork's business model involved leasing and renovating office spaces, then renting them out at premium rates to businesses and freelancers. The company offered a unique and upscale work environment with amenities like free beer, kombucha, hammocks, and rock-climbing walls, which contributed to its initial popularity.

However, WeWork's financial downfall can be attributed to several key factors. The company accumulated massive debt, partly funded by a $17 billion investment from SoftBank, to acquire a vast portfolio of leased office space. This expansion outpaced the demand for shared office space, leaving WeWork unable to offset its losses or meet its rent obligations, a situation worsened by the COVID-19 pandemic that forced remote work.

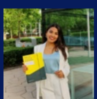
Experts point to a combination of an unprofitable business model and high debt levels as the root causes of WeWork's bankruptcy. WeWork's lavish spending and rapid growth couldn't sustain the financial pressures it faced.

WeWork's downfall also underscores broader issues related to the period of low-interest rates in the 2000s and 2010s. During this time, investors were eager to pour money into start-ups like WeWork in search of high returns, as borrowing expenses were minimal. The bankruptcy serves as a cautionary tale, illustrating the potential dangers of allocating capital recklessly in an environment of near-zero interest rates.

The recent increase in interest rates by the Federal Reserve signifies a shift away from the excesses of the past decades, making borrowing more expensive and, in turn, potentially discouraging speculative investments. This change reflects a growing awareness of the risks associated with "cheap money" and the need for more prudent allocation of capital.

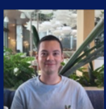
The Assets Committee

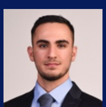

Calvin Barlow - Head of Assets

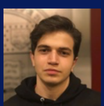

Nehal Singhal - Committee Member


Daniel Klingenberg - Committee Member

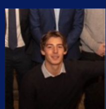

Bruno Bansky - Committee Member


Hugo van der Stap - Committee Member


Itay Zari - Committee Member


Kerem Koruk - Committee Member


Sara Ługowska - Committee Member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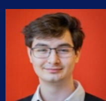
Alexander Thurner - Committee Member


Lyuboslav Panayotov - Committee Member


Nicolas Gregorics - Committee Member


Cristian Benciu - Committee Member

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