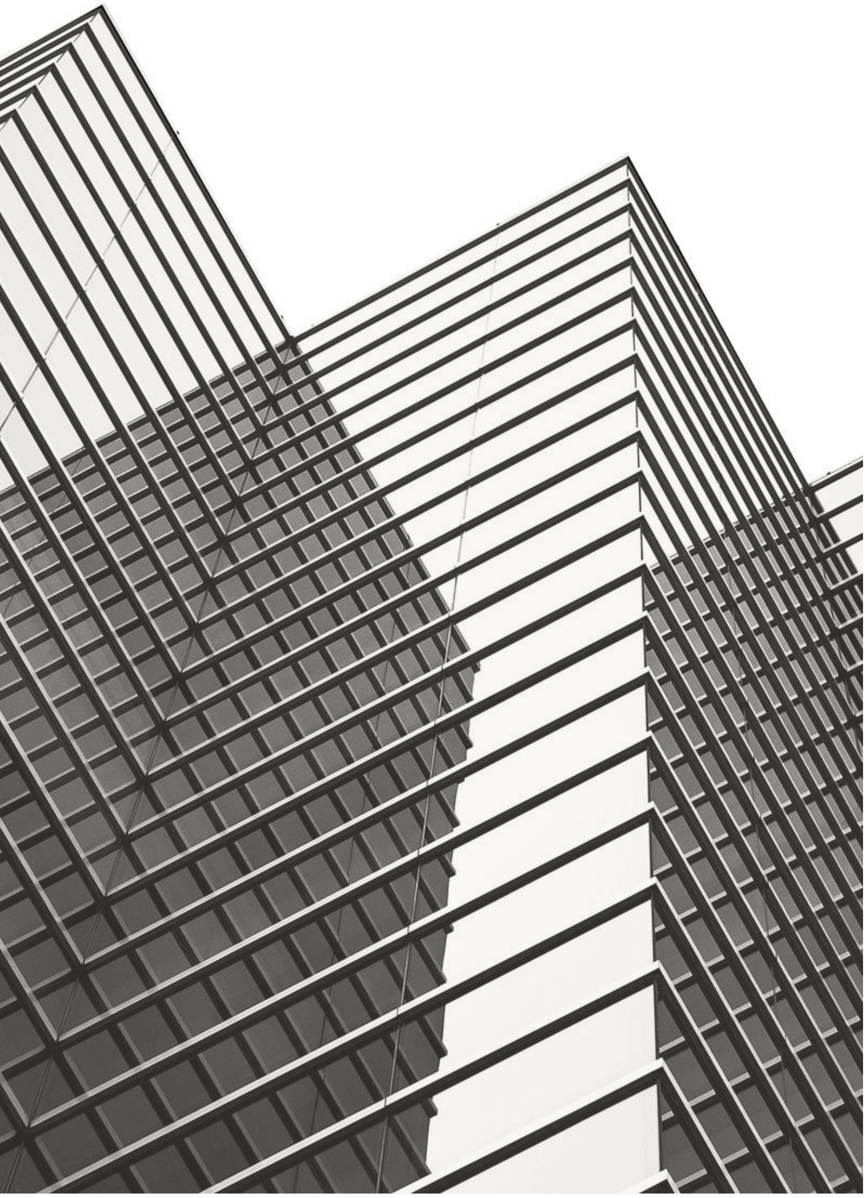
QUARTERLY REPORT

Q1 2023 - BANCA DEL SEMPIONE

BANCA DEL SEMPIONE
SIMPLON BANK
BANQUE DU SIMPLON



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MESSAGE – FINANCE AND MARKET DIVISION

Central banks, aided by resilient economic data, showed more decisiveness on the path to raising rates, after the delay in tightening monetary policy during 2022.

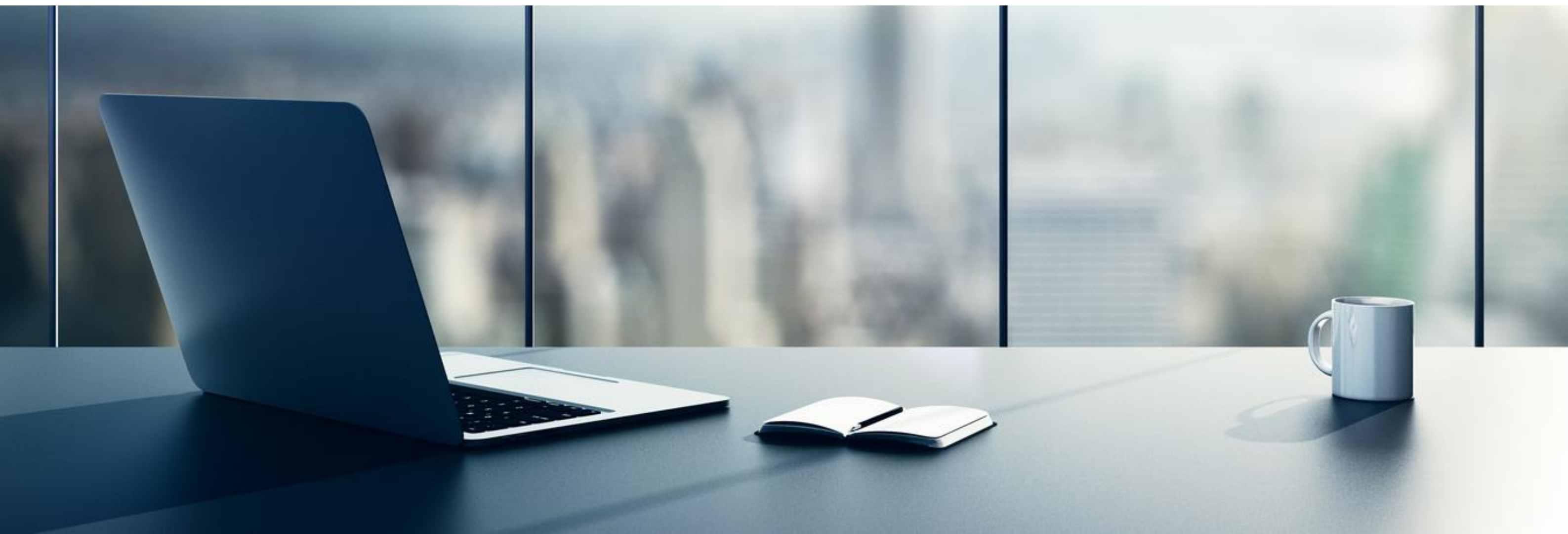
Market concerns, rather than focusing on growth, have in recent weeks been directed at the feared fragility of the banking system. The banking crises that have claimed victims in both the United States and the old continent are very different from one another. There is every reason to imagine that this particular one will lead to a slowdown in the economy, due to the tightening of lending standards. However, we cannot exclude that other elements may emerge, which could limit the negative effects of a credit crunch.

From this perspective, the bankruptcy of Silicon Valley Bank (SVB) or the wipe out of Credit Suisse’s AT1 bonds, or several other events that recently occurred, should not potentially mean sleepless nights for investors. Indeed, it is worth to learn from what happened, not to try to guess who the next victim will be, but rather to make some considerations about the investment process, which represents Banca del Sempione's core business. Investing doesn't mean to predict the future, but rather to understand the needs of each investor, identifying the correct time horizon and portfolio allocation. A well-structured portfolio may be subject to some inevitable fluctuations, but if properly built and professionally managed, it will only yield the expected results over time. Timing and consistency in an investment approach are the real ingredients for the result, rather than the ability to predict individual events.

Meanwhile, the financial markets offer attractive levels of return in the bond sector, which we prefer at this stage. In several areas, however, a fall back in prices would open up to investment opportunities in the equity sector as well. High-quality assets can act again as capital protection instruments able to generate positive returns, while individual market inefficiencies can be used as tactical opportunities. At this stage, however, due attention will have to be paid to concentration risk, which favours the use of actively managed funds or ETFs.

PIETRO SCIBONA

DEPUTY GENERAL MANAGER
HEAD OF THE FINANCE AND MARKETS DIVISION



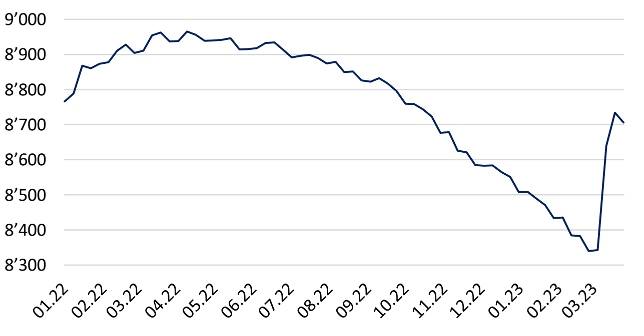
MACROECONOMIC OVERVIEW

Global economic scenario

The first quarter of 2023 was marked by an elevated grade of uncertainty related to the major developed countries' economies. In an initial phase between January and February, market consensus began to accept the idea of an economy capable of withstanding the aggressive restrictive monetary policy conducted by major central banks in 2022. Several macroeconomic indicators instilled confidence in investors: inflation showed the first signs of a slow decline, unemployment stabilized at its lowest levels in the last 30 years, and GDP appeared to be on a continuous growth trajectory. Central banks, too, seemed to soften the harsh tone of their rhetoric, opting for lower and more consistent rate hikes with the aim of adjusting future choices to evolving macroeconomic data.

In March, the panic generated by the banking sector reversed previous recovery expectations. The **Silicon Valley Bank** crash, caused by mismanagement of its financial assets – which did not keep up with the online "bank run" – created a wave of terror and speculation that damaged multiple banking realities globally. Then, the bailout of Switzerland's second largest credit institution, **Credit Suisse**, was added.

FED's balance sheet evolution
USD bn; 01.22 – 03.23



Source: Bloomberg

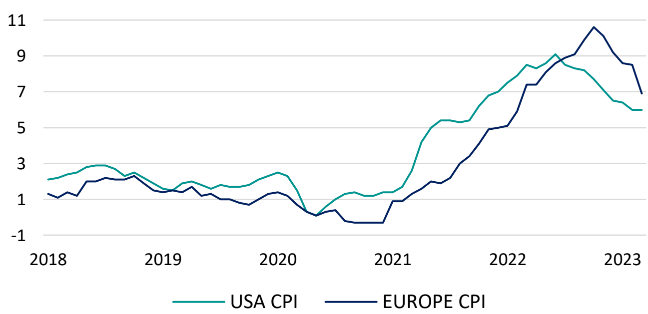
Authorities' and central banks' efforts to try and contain pressure on the financial sector – carried out in a timely manner through comforting statements, extensions of guarantees on client deposits, and billions of liquidity injections in the banking circuit – allowed the most risky institutions to be temporarily stabilized, limiting the damage on individual balance sheets.

However, as central banks themselves, including the US **Federal Reserve** (FED) and the **European Central Bank** (ECB), have stated, there is still considerable uncertainty about the consequences of this sudden paradigm shift, which will tend to amplify the impact of the restrictive policy implemented in 2022, through a tightening of lending and an adjustment of interest rates on loans and deposits. In the first quarter, both central banks launched two rate hikes each, with a total of 0.50 percentage point for the **FED** and 1 percentage point for the **ECB**.

The current environment is still marked by rather high inflation, mainly due to the steady rise in rents and service costs in **the US** and **Europe**, supported by an all-time low level of unemployment leading to upward wage bargaining. The current trajectory indicates that the inflationary peak has been exceeded and price increases have been more modest and closer to central bank targets, supported by stable or declining energy and commodity costs in the quarter.

The market is starting to price, especially in the US, a possible monetary policy reversal and rate cuts by central banks starting from the second half of this year, to support an economy on the brink of recession.

US and Europe Consumer Price Index
% YoY; 2018 – 2023



Source: Bloomberg

MACROECONOMIC OVERVIEW

Focus: geopolitical context and Switzerland

Geopolitical context

China: while relations with the United States and other NATO members are becoming increasingly tense – as shown by the dispute over the 'spy balloon' shot down off **South Carolina** and the rhetoric about China's **Taiwan** annexation plan – new alliances are rising among emerging countries driven by the **Communist Party of China**.
President **Xi Jinping**, following the confirmation of his mandate and the new government structure after the National People's Congress, took the opportunity to intensify relations with nations such as **Russia** and **Saudi Arabia**, in an attempt to create a new coalition capable of standing up to the powers of the West.

As regards the **Russian-Ukrainian conflict**, which continued to rage during the winter period, albeit at a more moderate pace, the main developments concerned the conditions for a possible peace between the countries. As **China** stands as a mediator, demands for surrender are heightened by the **Kremlin,** while the US and European contribution to the Ukrainian military corps is increasing with economic support and military supplies. The continuation of the conflict, whose first anniversary was on February the 20th, led to Putin's final indictment for war crimes and the deportation of Ukrainian children. This is not a reassuring sign for a definitive ceasefire in the near future.

During the quarter, new outbreaks of protests and strikes hit developed countries: the **United Kingdom** and other European nations recorded numerous strikes by the public workforce in the negotiation of wage levels; **France** witnessed violent protests after forcing the passage of a pension reform bill that raises the retirement age from 62 to 64; **Israel** preferred to suspend a judicial system reform that would have increased the control of the ruling coalition after massive population riots.
The geopolitical context therefore remains difficult to read and interpret.

Switzerland

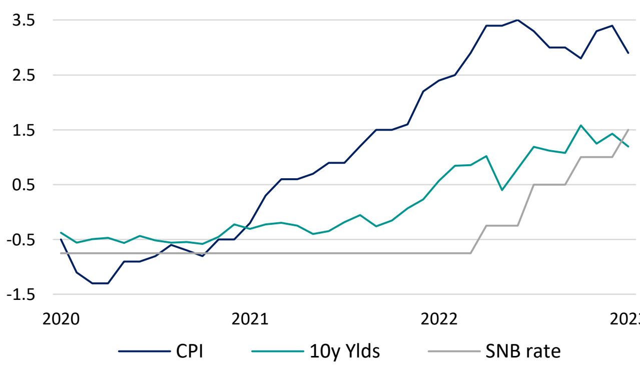
In the first quarter, the macroeconomic scenario in **Switzerland** benefited from a stabilization of the phenomena that characterized the previous year. The CPI basket was anchored below the 3.5% threshold, which was the highest level in August 2022. The first signs of a decline came from falling energy and service costs, offset by the persistent increase in food and consumer discretionary prices.

The **Swiss National Bank** (SNB) therefore decided on a further 0.5 percentage point rate increase on the 23rd of March, lifting the base interest rate to 1.5% and adjusting its inflation forecast upwards (expected to reach 2.6% by the end of the year). In its macroeconomic scenario, the SNB forecasts a 1% GDP growth by 2023, while the unemployment rate is expected to be at its current historically low levels.

The acquisition of **Credit Suisse** by **UBS** for approximately CHF 3 billion, announced on the 19th of March, was swiftly completed thanks to a joint action by the representatives of the two banks, the **Federal Council**, and the banking authorities (including the **SNB** and **FINMA**). More specifically, a CHF 100 billion liquidity assistance loan from the **SNB** helped to contain systemic damage in the Swiss and global banking sector.

Switzerland CPI, Government Yield and SNB Rate

%; 2020– 2023



Source: Bloomberg

FINANCIAL OVERVIEW

Equity market

Indices	Price	Quarterly Performance	YTD Performance
MSCI World	2,791.4	7.2%	7.2%
SMI	11,106.2	3.5%	3.5%
STOXX Europe 50	4,315.0	13.7%	13.7%
FTSE MIB	27,113.9	14.4%	14.4%
DAX	15,628.8	12.2%	12.2%
S&P 500	4,315.0	7.0%	7.0%
NASDAQ 100	13,181.3	20.5%	20.5%
Nikkei 225	28,041.5	7.5%	7.5%
Hang Seng	20,400.1	3.1%	3.1%

Source: Bloomberg

After a painful 2022 for global stock prices, closing in double-digit negative territory, 2023 started with more optimism. The year opened by inheriting not only December's good liquidity levels and expectations of central banks easing monetary policy, but also the ever-slowing inflation figures, with indices rebounding globally.
The Chinese reopening and continued resilient economic data from global economies kept sustaining stock prices, in addition to strong quarterly report earnings that on average beat analysts' expectations, with companies showing stable margins and a positive outlook for the rest of the year.

Market fears came from the failure of two US banks, **Silicon Valley Bank** and **Signature Bank**, both of which failed to handle the effects of the FED's rate hike on their balance sheets. The confidence crisis subsequently spread to Europe as well, hitting **Credit Suisse** and culminating in the intervention of the Swiss authorities and the "forced" takeover by **UBS**.

Looking at performance at the geographical and sector levels, European equities outperformed the US benchmark in the early part of the year, with the **Stoxx50** index returning close to its end-2021 levels.

The main reasons for this difference lie in Europe's lower valuations and in the composition of market indices, having a larger cyclical component within them.

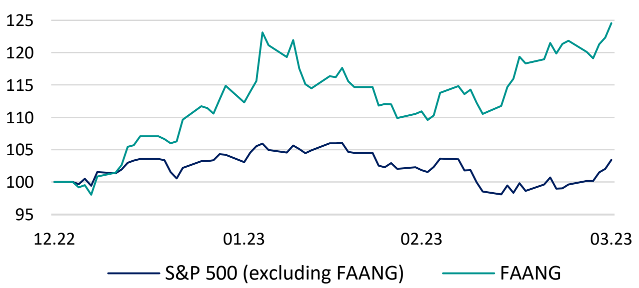
Europe: the top performers were the **luxury sector** (which benefited from positive outlook driven by the prospects of a strong rebound in Chinese demand) and the **more cyclical sectors** (such as finance and energy, even if they retraced in the second half of the quarter due to the banking crisis and renewed recessionary fears).

Switzerland: despite the good prospects, the SMI (Swiss Market Index) underperformed its European peers, due to two factors: the strongly defensive composition of the Swiss securities basket, dominated by pharmaceuticals (**Novartis** and **Roche**) and staples (**Nestlé**), and the vicissitudes that affected **UBS** and **Credit Suisse**.

Across the Atlantic, technology stocks bounced back from last year's lows. At the end of the quarter, the **Nasdaq 100** index benefited from declining terminal rate expectations and a generalized flight to quality in which investors focused on financially sound companies. After a few months of suffering, **FAANG** (Meta: Facebook, Apple, Amazon, Netflix and Alphabet: Google) returned to the spotlight, together with the **semiconductors** sector, which performed well thanks to a well-sustained demand.

<u>Big Tech's earnings in the US</u>

100; 12.22 – 03.23



Source: Bloomberg

In the background, emerging countries: **China**, which, despite the economic recovery begun with the end its zero-Covid policy, fails to convince investors still concerned about potential geopolitical issues. **India** with the **Adani Group** (one of the largest industrial conglomerates in the world), which came under attack from **Hindenburg**, a short selling fund that allegedly identified unclear practices in the management of its subsidiaries.

FINANCIAL OVERVIEW

Bond market

Government yields (in % p.a.)	2 years	5 years	10 years
Switzerland	1.18	1.16	1.20
Italy	3.16	3.60	4.09
Germany	2.67	2.31	2.29
United States	4.03	3.57	3.47

Source: Bloomberg

After a disappointing 2022 in which the bond market reported record losses, paying the price of so many years of zero or negative interest rates, the current year presents itself as the beginning of a new period of renewed interest in fixed-income investment.

Higher interest rates, however, are not yet accompanied by the stability desired by investors. In particular, March will be remembered for the volatility records recorded by **government bonds'**, particularly in **Europe** and **the United States**.

This uncertainty is primarily linked to the future trend of interest rates: in the absence of clear indications from central banks, which aim to retain ample room for manoeuvre in terms of future choices, the market is extremely sensitive to any change in economic growth and inflation forecasts.

As long as the macroeconomic situation remains unstable, and the forecasting models used by central banks prove inaccurate, it is highly likely that interest rate market volatility will not disappear. But, in the absence of major upheavals, the bulk of interest rate hikes may now be behind us, and the downward trend in government bonds may have come to an end, leaving room for a wide-range sideways movement.

With regard to **credit spreads**, the quarter showed a rather see-sawing trend. In the first few weeks of the year, the hope of seeing inflation decline without violent economic recessions (so-called *soft landing*) led to lower spreads. The Crossover Index (representing the credit risk of European high-yield companies) contracted from 480 to 380. January's confidence quickly waned in the following months, owing to continued inflationary pressures and fears of a banking crisis in the United States.

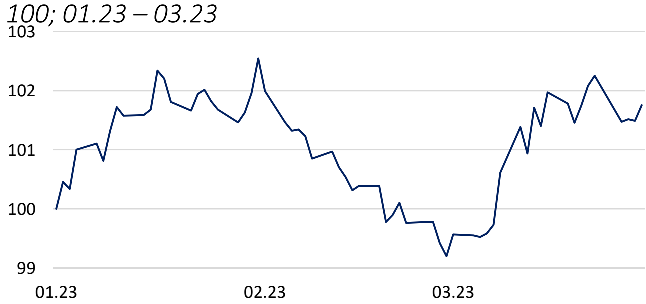
The **credit segment** thus ended the quarter roughly unchanged, with financial bonds significantly under-performing. At the government level, the spread between the European periphery, **Italy** in particular, and **core countries** has remained fairly stable, indicating that the market at the moment is not particularly afraid of the impact of the ECB's bond purchase plan coming to an end.

Emerging markets continue to struggle to attract constant inflows, despite the fact that central banks in many countries have acted more quickly than the **Fed** and the **ECB**. Both hard currency bonds – denominated in euros or dollars – and local currency bonds are confined to a sideways trading range, and appear to require a decisive monetary-policy shift by the Fed to recover relative performance.

Despite risks and high volatility, the market has easily absorbed new government and corporate issues, which were particularly high in the first weeks of the year. Such behaviour indicates that there is strong demand for bonds, and signals that higher rates can attract inflows, which had been lacking in recent years, replacing central banks' quantitative easing programs.

<u>Global Bond Index</u>

100; 01.23 – 03.23



Source: Bloomberg

FINANCIAL OVERVIEW

Currencies	Price	Quarterly Performance	Yearly Performance
EUR/CHF	0.992	0.26%	0.26%
USD/CHF	0,915	-1.00%	-1.00%
EUR/USD	1,084	1.25%	1.25%
GBP/USD	1.234	2.10%	2.10%
USD/JPY	132.86	1.33%	1.33%

Source: Bloomberg

Currencies

As mentioned in the macroeconomic section of this report, the first quarter of 2023 saw central banks continuing on the path toward the interest rate deemed fit to bring inflation back under control.

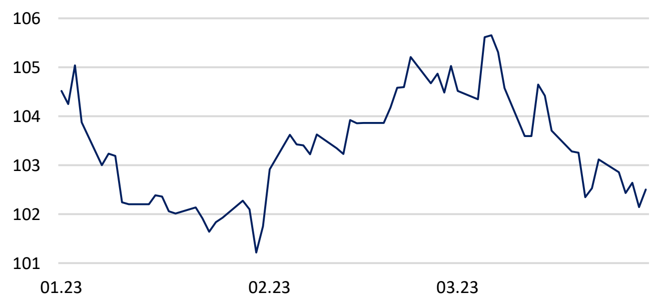
The EUR/USD exchange rate has on several occasions reached the 1.10 level during the quarter, driven by central banks with different paces of rate increase and by a general positive attitude toward the European context, which was severely penalized during 2022.

In Japan, the appointment of the new BOJ governor places more focus on potential changes from the decades-long accommodative policy of his predecessor, Kuroda, with a Yen that has remained stable against the US dollar.

The Swiss franc remains strong, thanks to the SNB's increases in deposit rates and its willingness to intervene in the exchange rate market. In the quarter under review, the EUR/CHF exchange rate stabilized around parity, while remaining at all-time lows against the dollar. The latter has shown great volatility since the beginning of the year (see US Dollar Index (DXY), where the USD is compared to a basket of six global currencies).

Us Dollar Index (DXY)

%; 01.23– 03.23



Source: Bloomberg

Commodities	Price	Quarterly Performance	Yearly Performance
WTI Oil	75.67	-5.72%	-5.72%
Brent Oil	79.77	-7.15%	-7.15%
Natural Gas TTF	47.00	-36.49%	-36.49%
Gold	1,969.28	7.96%	7.96%

Source: Bloomberg

Commodities

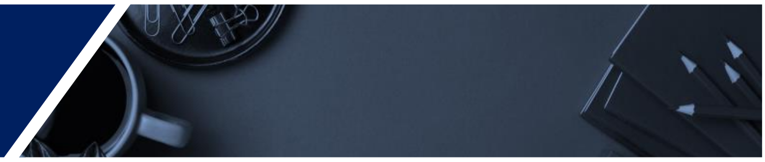
In general, commodities fell slightly in the first quarter, as recorded by the aggregate ***Bloomberg Commodity Index***, down by 4.4% since the end of last year.

The energy market displayed a mixed trend. On the one hand, the price of WTI oil remained stable between $72 and $80 per barrel, falling in March due to the risks of recession induced by the banking crisis, but recovering quickly and closing the quarter down by 5.7%. On the other hand, the price of natural gas decreased significantly to almost pre-energy crisis levels, thanks to mild temperatures this winter and the reopening of a large liquid natural gas plant in Texas posting a price reduction of 36% in Europe and 38% in the US.

A favourable combination of factors, such as the acceptance of higher interest rates than in the past, a weak dollar, persistent inflation, and the role of a safe haven asset, have brought gold back close to the $2,000 per ounce threshold. There is also evidence of gold purchases by several central banks, including China, which has expanded its gold reserves to replace its US dollar and US treasury stocks.

Other commodities, such as industrial metals, have experienced slight declines in prices, stemming from a decline in forecasts of Chinese and global economic growth, while supply shortages have led to greater stability in food prices.

Did you know that...



> *…A clause in the issuance prospectus of Credit Suisse's AT1 bonds provided that […] the debt in question would be permanently written off*

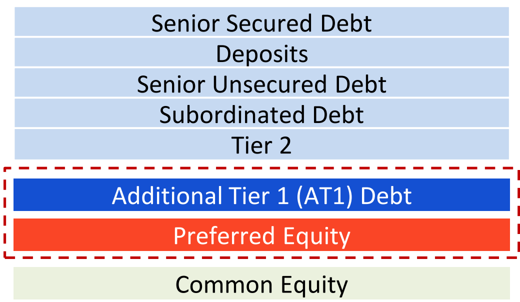
The 19th of March, following the announcement of the acquisition of Credit Suisse by UBS, the Banking Supervisory Authority (FINMA) ordered the complete write-down of the so-called AT1 bonds.

What are AT1 bonds?

These are subordinated bonds issued by banks following Basel III capital structure requirements, and have the aim of absorbing the losses experienced by a credit institution in financial difficulties by cancelling coupons and - temporarily or permanently - converting debt into equity or simply writing it off. They are issued by banks without a maturity date (with early redemption options) on a recurring basis, in order to meet the capitalization thresholds imposed by the supervisory authority. Due to the subordinate nature and lower average rating of these types of bond, the yield to maturity is likely to be higher than senior debt.

What happened to Credit Suisse's AT1 bonds?

A clause in the issuance prospectus of Swiss AT1 bonds, including Credit Suisse's, provided that, in the event of insolvency of a credit institution, the debt issued through these instruments would be permanently written down. Few markets have this peculiarity and between them the Swiss market, this has allowed FINMA to write off the AT1 Credit Suisse debt equivalent to approximately CHF 16 billion, held mainly by institutional investors. The market-disrupting factor was the treatment of this bond class in relation to the banks' equity capital, which is normally the first to bear losses, whereas in this case it was partially remunerated de facto putting AT1 holder below Equity in the capital structure.



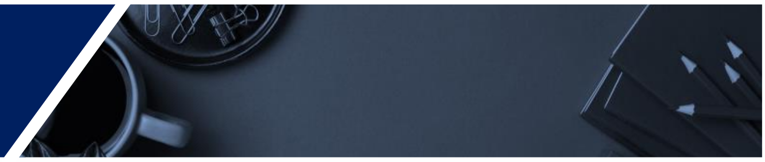
Source: Invesco

KEY TAKEAWAYS

1 - CS AT1 BOND MARKET VALUE BEFORE WRITE-DOWN:	2 – CS CET1[1] RATIO AS OF 31.12.2022:	3 - YEAR OF THE FIRST EUROPEAN AT1 BOND ISSUANCE
CHF 16 Bn	**14.1%**	**2013**

1. Banks' Regulatory Capital measure calculated as the ratio of Tier 1 capital with its Risk Weighted Assets

Expert Talk
Giorgio Bertoli



What is actually happening on the bond market?

Interview with ***Giorgio Bertoli****. Fund Manager of Flexible Low Risk Exposure :*

The wipe-out of the AT1 bonds issued by Credit Suisse has generated considerable market turmoil, and left investors with doubts. What impact can we expect on European banks capital market?

The bank capital structure, regulated by Basel III, is more complex than in the past and requires special attention from the investor. The presence of bail-in instruments (such as AT1) makes it possible to write down bonds temporarily or permanently, even in the absence of a bank's bankruptcy or liquidation.

A high-impact event like the one involving Credit Suisse has changed the perception of risk by some investors, who will reconsider their exposures and tend to abandon the subordinated bank debt segment. New institutional investors will take their place, but this change will likely be accompanied by a demand for structurally higher returns.

What approach are you taking in relation to financial bonds, in light of these developments?

Financial bonds are and will be a key component of the bond sector. We interpret recent developments as an opportunity to generate value for our investors, despite the risks arising from increased market volatility.

When forced liquidations or panic-induced sales occur, buying opportunities are created for those who have a greater grasp of credit fundamentals. The European banking system as a whole is healthy and well capitalized, it seems well equipped to meet the challenge of a drastic and very rapid monetary policy change. However, the selection of issuers remains crucial, since it cannot be excluded that some particularly weak institutions may encounter specific difficulties.

A diversified approach to financial credit will therefore remain part of our bond strategies, and a higher risk premium on the bank bond market will have a long-term positive impact on the returns of our products.

“*The European banking system as a whole is healthy and well capitalized, it seems well equipped to meet the challenge of a drastic and very rapid monetary policy change*”

GIORGIO BERTOLI

Manager of Flexible Low Risk Exposure

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