EARNINGS SEASON RESULTS SHED A POSITIVE LIGHT ON FINANCIALS

Wisdomtree EU
24 May 2021

Earnings season results are in for companies within the Euro Stoxx 50. The financial sector delivered one of the strongest earning surges across all sectors, 38% of company reported earnings beating concensus analyst expectations. Compared to the last quarter[1], earnings growth for the consumer discretionary sector was strong, reflecting the return of the consumer this year following the covid-19 vaccine roll-out which has helped economies transition out of lockdowns. Financials also benefited from a robust pick up in earnings growth from last quarter with 48% of companies reporting earnings growth[2]. In this blog, we will explore one of the sectors that delivered strong first quarter earnings results and the implications this may have for the bond market.

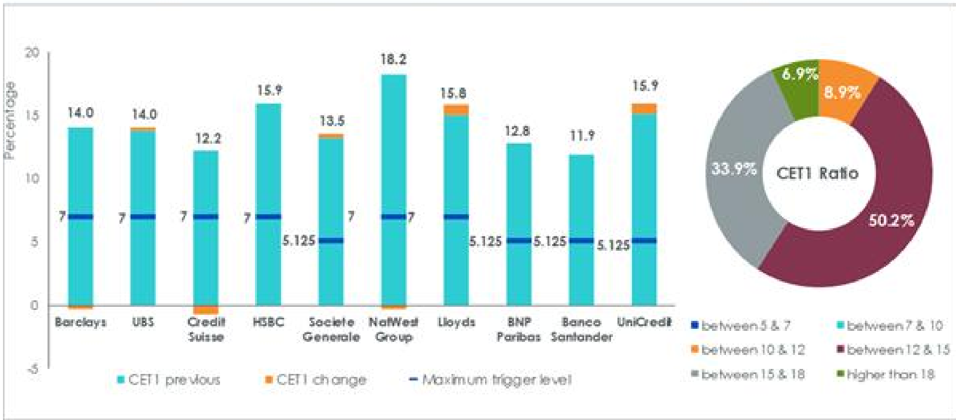
What does earnings season tell us about the market's perception of risk for corporate bonds?

Option adjusted spreads (OAS) for both US high yield and Euro high yield bonds were lower in May compared to the start of 2021. OAS is typically the spread above the risk-free rate that aims to compensate investors for liquidity and credit risk. High OAS levels indicate that the market is concerned about the credit or liquidity risk of a bond.

With the OAS for US high yield bonds falling by 16%[3] this year, investors are signalling a more optimistic outlook for companies with higher credit risk. OAS peaked in March 2020 for corporate bonds and has fallen considerably since those peak levels, signalling cheaper borrowing costs for companies and a more supportive operating environment for corporates[4]. Similarly, in April 2020, OAS for European banks and their Additional Contingent Convertible bonds (AT1 CoCo) bonds recovered from a significant high. With the OAS for many corporate bonds at seemingly lower levels, investors have turned to relative value opportunities to optimise their portfolios. In this part of the investment cycle, sectors that could benefit from the improving macro backdrop are likely to gain more investor attention.

Considering the Q1 2021 earnings season, how are the CET1 ratios of European banks[5] holding up?

Top 10 AT1 CoCo issuers CET1 ratios and AT1 CoCo Issuers CET1 ratio breakdown



*Source: WisdomTree, Markit, Bloomberg, respective issuers financial results. Data as of 30 April 2021. **CET1 change** represents value change in CET1 ratios from data available as of 31 March 2021 (generally Q4 2020 available reporting) compared to latest data available as of 12 May 2021 (generally Q1 2021 available reporting). No change may indicate reporting cycle has not ended. **CET1 ratio** is the Common Equity Tier 1 Capital ratio reported on a fully loaded basis available on Bloomberg and from the issuer's latest financial results, if not reflected on Bloomberg. **Maximum trigger level** is represented by the maximum trigger observed across all CoCo issues of a given issuer. The strategy is represented by the iBoxx Contingent Convertible Liquid Developed Europe AT1 Index.*

You cannot invest directly in an index. Historical performance is not an indication of future performance and any investments may go down in value.

European banks[6] maintain buffers to their maximum trigger ratios for their AT1 CoCos. Italian banks have increased their common equity tier 1 (CET1) ratios[7] in Q1 2021 compared to Q4 2020 which is supported by stronger than expected Q1 results. Credit Suisse, which made headlines this year, reported a drop in their CET1 ratio by 0.70% for the same period but maintained a buffer to their maximum trigger ratio of 5.20%. Nationwide Building Society, which typically issues their AT1 CoCos in sterling, maintained a high buffer to their maximum trigger ratio of 27.50%.

While it is never easy picking the winners from the losers, the potential for one-off events like the Greensill debacle make it even harder to predict future returns. Strategies that provide access to a diversified basket of bank issuers may become a useful tool for investors seeking a yield pick-up relative to other corners of the fixed income market.

Sources

[1] Source: Bloomberg, as of 17 May 2021, first quarter 2021 earnings reported compared to fourth quarter 2020 earnings reported for companies within the Euro Stoxx 50 price index (SX5E).

[2] Source: Bloomberg, as of 17 May 2021, first quarter 2021 earnings reported compared to fourth quarter 2020 earnings reported for companies within the Euro Stoxx 50 price index (SX5E).

[3] from January 2021 to May 2021

[4] Source: Bloomberg, as of 17 May 2021, credit dashboard BI STRTE considering

OAS since November 2019 to May 2021.

[5] Source: European banks is represented by the iBoxx Contingent Convertible Liquid Developed Europe AT1 Index.

[6] Source: European banks is represented by the iBoxx Contingent Convertible Liquid Developed Europe AT1 Index.

[7] Source: Common equity tier 1 ratio aims to compare a bank's capital against its assets.

Related Blogs

+ AT1 CoCos continue to shine amid rising bond yields

Related products

+ WisdomTree AT1 CoCo Bond UCITS ETF - USD (CCBO)

View the online version of this article here.

Important Information

Marketing communications issued in the European Economic Area ("EEA"): This document has been issued and approved by WisdomTree Ireland Limited, which is authorised and regulated by the Central Bank of Ireland.

Marketing communications issued in jurisdictions outside of the EEA: This document has been issued and approved by WisdomTree UK Limited, which is authorised and regulated by the United Kingdom Financial Conduct Authority.

WisdomTree Ireland Limited and WisdomTree UK Limited are each referred to as "WisdomTree" (as applicable). Our Conflicts of Interest Policy and Inventory are available on request.

For professional clients only. The information contained in this document is for your general information only and is neither an offer for sale nor a solicitation of an offer to buy securities or shares. This document should not be used as the basis for any investment decision. Investments may go up or down in value and you may lose some or all of the amount invested. Past performance is not necessarily a guide to future performance. Any decision to invest should be based on the information contained in the appropriate prospectus and after seeking independent investment, tax and legal advice.

The application of regulations and tax laws can often lead to a number of different interpretations. Any views or opinions expressed in this communication represent the views of WisdomTree and should not be construed as regulatory, tax or legal advice. WisdomTree makes no warranty or representation as to the accuracy of any of the views or opinions expressed in this communication. Any decision to invest should be based on the information contained in the appropriate prospectus and after seeking independent investment, tax and legal advice.

This document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public offering of shares or securities in the United States or any province or territory thereof. Neither this document nor any copy hereof should be taken, transmitted or distributed (directly or indirectly) into the United States.

Although WisdomTree endeavours to ensure the accuracy of the content in this document, WisdomTree does not warrant or guarantee its accuracy or correctness. Where WisdomTree has expressed its own opinions related to product or market activity, these views may change. Neither WisdomTree, nor any affiliate, nor any of their respective officers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or its contents.