# Market Commentary on the Q1'2023 Results Season:

## *From Financial Contagion to Credit Contraction?*

Just when the first signs of slowing inflation appeared at the beginning of the year, and hopes for an economic recovery towards the second half of 2023 resurfaced,[i] the **sudden and material outflow of deposits from some regional and communal banks in the US** – a combination of poor risk management, inadequate business diversification as well as lapses in supervision and regulation – not only led to a number of bank failures but **also renewed fears about financial contagion into the wider economy** and, most importantly, **credit contraction leading to recession and stagflation**.[ii] While we currently witness a reversal of the previously pandemic-induced excess demand and supply constraints,[iii] with the world economy simultaneously navigating through energy transition, supply chain adjustments and new employment trends, the **paradigm shift of political intervention into economic decision making** on the grounds of national security considerations is something corporate executives became increasingly vocal about when discussing investment strategies.[iv]

Given continuing uncertainty of the economic outlook for 2023 under high inflation,[v] the **better-than-expected performance in Q1'2023** was perhaps a surprise for some companies,[vi] notably with **Europe being more resilient than originally expected**,[vii] although senior management is equally cognisant that Q2'2023 might turn out to be very different.[viii] There is a broad consensus among corporate decision makers that we are in **a period of "gradual easing of a number of issues"** (Mark Schneider, CEO of Nestle), but we also hear different interpretations of why there has been a **renewed temporary build-up of inventory**, whether this is more psychology related when placing orders in the New Year (Fagerhult) or whether this is due to **continuing problems with short-distance truck deliveries** in Europe and the US due to labour shortages (Trelleborg, Palfinger). Looking forward, there is not only a "modest disinflationary impact of raw materials and freight in Q2'2023" (Maarten van Vries, CFO of AkzoNobel), but also the **companies' ability to deal with high inflation much better than in previous periods**, largely due to the shift away from manufacturing to technology, intangibles and finances.[ix]

Some of these **structural changes and post-pandemic secular trends are the major focus point** of our current market analysis, whether it relates to **employment trends or supply chain adjustments.** We illustrate these shift changes in a **special case study on the airlines industry**, which not only experienced an impressive rebound after the pandemic, but also shows clear signs of changing customer behaviour leading to adaptations of the business model. However, we first look at the **debate on the recent banking crisis**, its implications for the broader economy and first lessons, as well as recent **regulatory changes for capital markets in the US and Europe**. As we had frequently written on shareholder activism before, the last few months had witnessed a **growing and turbulent level of activist campaigns against small and large companies** on both sides of the Atlantic (and increasingly Asia), and we feature a special section highlighting some of the key themes.

## BANKING IN DISARRAY

While the failures of Silicon Valley Bank, Signature Bank and Silvergate were seen as idiosyncratic and largely a result of mismanagement, the more interesting debate is to what extent this originated due to the sudden shift in the interest rate regime, having caught some institutions offside and leading now to a more generalised tightening of lending standards.[x] Following a decade of low interest rates and easy money distorting capital allocations, the surprising development was to what extent the meltdown of a limited number of small US banks caused financial contagion even for "systemically important" larger institutions, triggering the rescue of Credit Suisse and reported attacks on Deutsche Bank.[xi] While this is not the place to discuss all the intricacies of the current (and still evolving) banking crisis, from our perspective the challenge of the existing bank business model at a time of massive tightening of policy rates and central bank balance sheet reduction has ramifications for the wider economy, notably credit provision and lending terms.[xii]

The challenge for the banking model originates in business operations, funding and default not having been adequately tested under conditions of a sudden rates shift, as evidenced by the extent of turmoil in the crypto industry and for UK pension funds in 2022 and, more recently, in the commercial real estate industry.[xiii] With the current reduction in the quantity of capital, what some market observers label "quantitative destruction",[xiv] not only small banking institutions but also alternative assets and non-bank financial institutions (private debt and equity), which had massively gained from zero rates and easy liquidity before, have now come under financial stress. The latter may lead not only to more financial failures, but also to a systemic crisis. As interest rates and bond yields trend higher, risk-taking behaviour as well as risk management regulation will have to change along monetary policy.[xv]

## REGULATORY CHANGES

While the recent banking turmoil calls for a more stringent regulatory regime for the entire financial industry, including additional scrutiny on investment managers, insurers and other non-bank financial groups, focusing specifically on leverage, liquidity risk and maturity mismatch,[xvi] we prefer to discuss in this section recent regulatory changes for capital markets, which perhaps fell somewhat off the radar screen given all the noise related to the banking crisis.

With the SEC in the driving seat for the most sweeping overhaul of stock trading in almost two decades, aiming to improve prices and transparency for small investors, there is a natural resistance from market-making firms that dominate the system.[xvii] After the pandemic lockdowns had prompted an explosion of retail trading activity, this was another attempt to establish a level playing field among different constituents of the US market, including wholesalers, dark pools and lit exchanges.[xviii] The most controversial plan is the attempt to extend the "best execution" regime by essentially mandating brokers to make all efforts to find the best price for retail investors, in line with similar standards for other investors.

In the wake of the crypto crisis last year, European (including UK) regulators are actively preparing proposals to oversee the crypto industry, with the EU's Markets in Crypto Assets (Mica) regulation coming into force in 2024 and the UK also unveiling new rules earlier this year.[xix] However, the most profound market reform in the EU relates to the attempt to provide a single database for live records of stock and bond trading information, with stock exchanges being reportedly reluctant to hand over their data, which deprives them of lucrative revenues and potentially undermines the viability of some of the smaller European stock exchanges.[xx] The so-called "consolidated tape" is an attempt to overcome highly fragmented European markets, with trading scattered between national exchanges, alternative trading venues and private market places, essentially following in the footsteps of US trading platforms jointly publishing real-time equity data. Interestingly, some of the concerns brought forward by executives from European bourses include the argument that retail investors would be deprived of "arbitrage opportunities", in disadvantage to hedge funds and high-frequency traders (Stephane Boujnah, CEO of Euronext).[xxi]

## SHAREHOLDER ACTIVISM

Against the backdrop of a subdued global M&A landscape in recent months, shareholder activism has been as vibrant as ever, with the total number of global activist campaigns up by 36% year-on-year in 2022.[xxii] Remarkably, next to the technology sector, mainly industrials have been targeted, notably Engineering & Construction and Machinery, with most of the campaigns pressing for the sale of assets and/or industry consolidation. When looking into the statistics for Q1'2023, not only the quarter-on-quarter number of activist campaigns has increased, but also now Europe accounts for 30% of global activism, with a surge of calls for divestitures.[xxiii] There is also a clear trend of mega-caps getting increasingly targeted, although small companies typically remain under the radar screen of mainstream press coverage.[xxiv]

There are a couple of observations from the recent activist campaigns against mega-caps: a) while typically seasoned activist investors have the clout and experience to attack large companies (Chris Hohn/Airbus, Jeff Ubben/Bayer, Elliott/Salesforce, Nelson Peltz/Disney), there are also smaller hedge funds and NGOs campaigning successfully, as the case of Danone has shown;[xxv] b) when it comes to climate goals and CO2 emission reduction, large companies are often taken on by a group of institutional activists led by prominent ESG specialists;[xxvi] c) within the ESG activist debate, "healthy food" has gained new prominence amid the pressure on food companies to make their products more nutritious;[xxvii] d) leading fund management firms are now increasingly getting under fire due to claims of "greenwashing" and misleading their clients;[xxviii] e) activists have been largely successful by taking aim at established CEOs (Jeff Ubben/Bayer), forcing restructuring (Elliott/Salesforce), reinstating dividends (Nelson Peltz/Disney) and/or preventing M&A transactions (Chris Hohn/Airbus);[xxix] and f) Asian companies, notably Japanese, have increasingly become targets of successful activist campaigns.[xxx]

## SUPPLY CHAIN ADJUSTMENTS

Supply chains have been one of the main discussion points during the Q1'2023 reporting season as companies not only continue to face shortages in electronic components, raw materials and logistics but also supply chain challenges still have an impact on order and production activity.[xxxi] While the "unwinding of strategic inventory built during the pandemic continues" (Zachary Kirkhorn, CFO of Tesla), in the wake of growing geopolitical, cyber risk and trade tensions there is a paradigm shift from efficiency to resilience,[xxxii] often including "friendshoring", localising and/or doubling of supply chains, which ultimately adds more costs and uncertainty.[xxxiii] Interestingly, the latest Gartner report on the "Top 25 supply chain companies" points to a wider set of factors supporting supply chain resilience, including a "broad sustainability agenda" (including Scope 3 GHG reductions with suppliers and customers) and "human-centric digital automation" (advanced analytics and data, robotics and digital twins).[xxxiv]

After the re-opening of China in December 2022, combined with all the discussions about economic "de-coupling" and "de-risking", it is no surprise that most of the analyst enquiries at Q1'2023 focused on the economic re-engagement and re-integration of supply chains with Western businesses (ASML, TSMC, Tesla, Mercedes Benz).[xxxv] There are three major points of current investor interest: a) to what extent can the established supply chains in China be replaced by India and other Asian (or even Latin American and African) emerging markets;[xxxvi] b) what the current geopolitical tensions imply for Western companies operating in China;[xxxvii] and c) whether to commit any further investments into China as the risk of a military aggression against Taiwan intensifies.[xxxviii] While still facing a high concentration of rare earth minerals in China and semiconductor production in Taiwan, supply chains will no doubt evolve in a changing multi-polar world.

EMPLOYMENT TRENDS

Given the continuing labour shortages in major Western economies, notably in terms of qualified labour, and the ongoing wage-price-spiral, other major discussion points during the Q1'2023 results season included the newly evolving employment trends. Massive lay-offs in recent weeks, particularly by US technology companies,[xxxix] and the shift to contract work have been well covered,[xl] but it is the underlying demographics and changing work preferences after the pandemic, notably by Generation Z, which keeps puzzling senior management and investors alike.[xli] More flexibility through hybrid work has been tested by most companies so far, and first research has already shown benefits in terms of higher productivity and employee morale, however issues of meeting in person, training and mentoring of young people still remain critical.[xlii]

While significant wage increases have been very much on corporate executives' mind when discussing the outlook for Q2'2023 (A1 Group, KPN, AkzoNobel),[xliii] there is also the continuing need for more training (Boeing, Delta Air Lines) which adds to costs going forward. At the same time, the role of labour is being newly defined as a "complete overhaul and transformation of the industrial system" (James Farley, CEO of Ford) is gathering pace, focusing on lean manufacturing, efficient operating systems and robust supply chains and procurement.[xliv] While there might be some discussion about older workers getting back to work and/or providing more jobs for non-active young people,[xlv] the recent boom of investments into robotics, industrial automation and generative artificial intelligence tells a different story. The global car industry, going through its own transformation from combustion engines to electric vehicles, provides a good example in this debate as it will require up to 40% less workers to produce EVs (as estimated by Ford).[xlvi]

CASE STUDY: AIRLINES INDUSTRY

We have closely followed the airlines industry since summer of 2022, as it not only went through an impressive post-pandemic rebound, but also appears to be resilient to recessionary fears so far, with people booking their holidays as if there were no second chance. The industry has certainly not gone through a V-shaped post-pandemic recovery, as it not only took time to ramp up capacity, re-build networks and re-employ (and train new) labour, most importantly pilots, but also supply chain issues at major aircraft manufacturers caused problems in terms of fleet restoration (and fleet renewal to meet sustainability targets).[xlvii] As we had mostly focused on structural changes and post-pandemic secular trends in this analysis, the airlines industry provides a great example how booking patterns and customer behaviour have both changed as well as forced airline companies to adapt their business model.[xlviii] At the same time, it illustrates the reversal of the supply/demand mis-match caused by the pandemic as well as, equally, the need of time to ease supply constraints, both in terms of aircraft availability and utilisation, while also facing airport disruption last summer.[xlix]

In terms of adjusting the airlines' business model, there are a number of factors being described by industry executives as "structurally different" (Scott Kirby, CEO of United Airlines): a) the change in peak demand making capacity planning less bumpy; b) the feeding of long-haul international demand into domestic flights; c) macro risks being higher with a view to the closing of China; and d) cost control becoming paramount (with the industry's track record being patchy at best).[l] Given the remaining constraints of infrastructure and pilot shortages, with labour contracts still being re-negotiated, airlines have made a huge effort in improving their digital offer, moving away from traditional travel agents to direct online sales, enhancing passenger brand awareness through various improvements in cabin seating (and newly differentiating between first, business and economy classes), overhead lockers, services and Wifi upgrades as well as loyalty programmes (with a stronger focus on airlines' membership cards).[li]

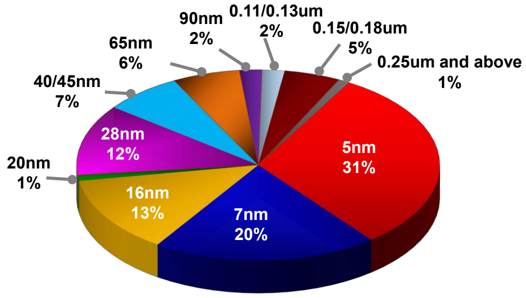
In terms of European airlines, the post-pandemic recovery has been somewhat slower, notably in business flights,[lii] with pressure on profitability coming not only from less premium seats sold when compared to 2019 but also from higher fuel costs, wage pressure and cost inflation for landing slots and luggage handling.[liii] While incumbent operators continue to perceive "key success factors" in their multi-hub and multi-brand/product strategy (Carsten Spohr, CEO of Lufthansa), budget airlines have intensified their efforts in terms of ramping up capacity, network extension, fleet renewal, cost reduction and enhancing customer loyalty through new services (WizzAir, Ryanair).[liv] Both in Europe and the US, passengers seem to be undeterred by higher fares, currently prioritising discretionary expenses for holidays at the expense of consumer goods, which is interesting to watch in case of inflation staying higher for longer and unemployment rising under a recessionary scenario in future.

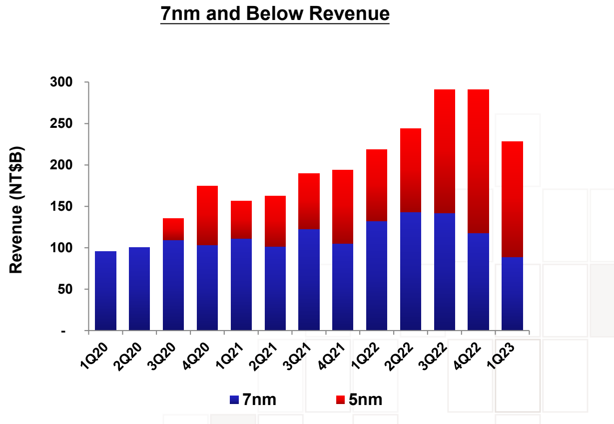
Peter and Irina Kirkow
2 May 2023

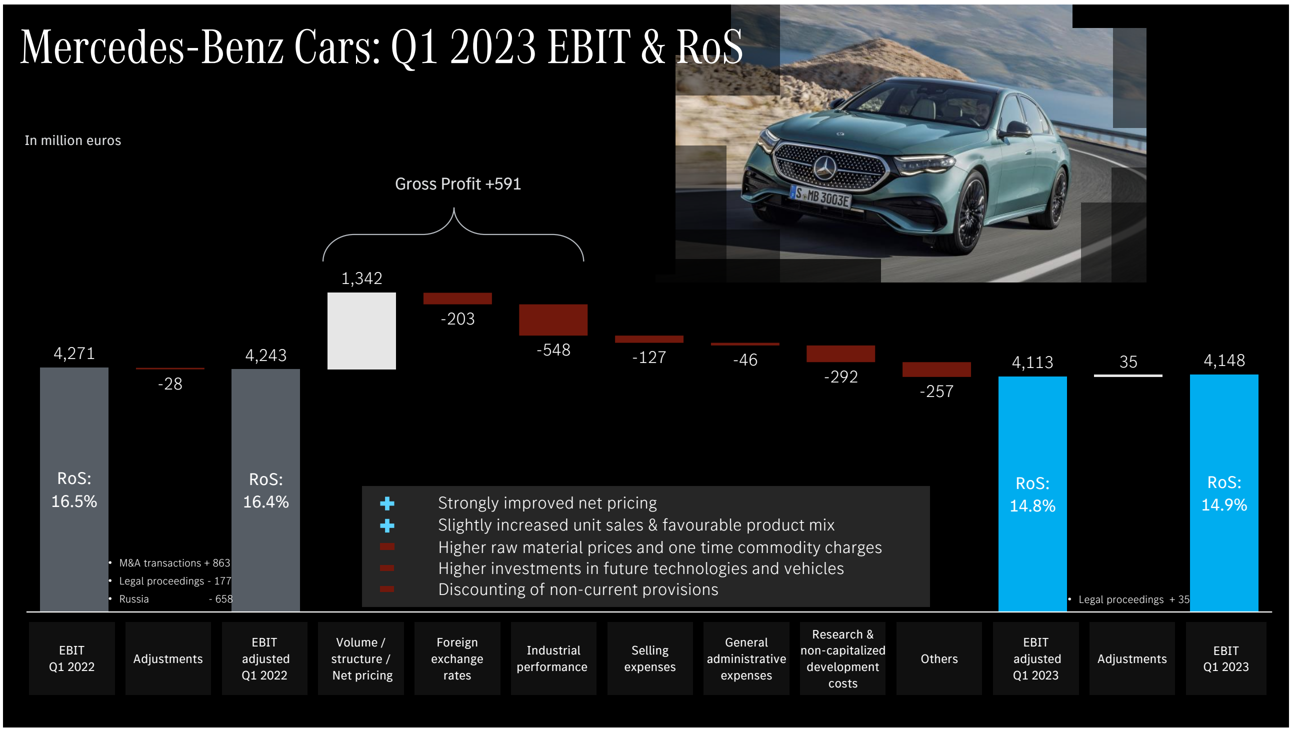
# APPENDIX

## 1Q23 Revenue by Technology

Unleash Innovatio

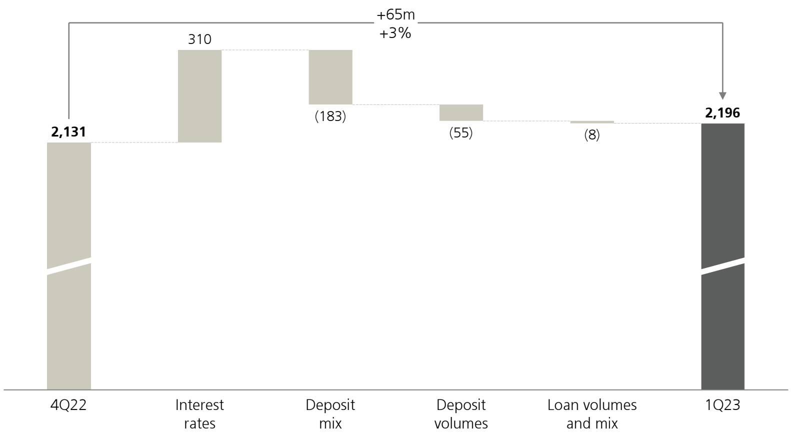


## Net interest income

Net interest income
GWM + P&C
m




GWM + P&C

### 1Q23

NII of 2,196, +65m QoQ, +3% and +520m YoY, +31%

– Total customer deposits in P&C and GWM (3%) QoQ as deposit inflows from external sources were more than offset by shifts into money market funds and T-Bills

### 2Q23e

Based on current forwards, we expect a mid-single digit percentage decrease in 2Q23 against 1Q23 NII for GWM and P&C combined[1]

### FY23e

Based on current forwards, GWM + P&C NII expected to be broadly in line with 4Q22 annualized[1]

UBS 1 UBS standalone

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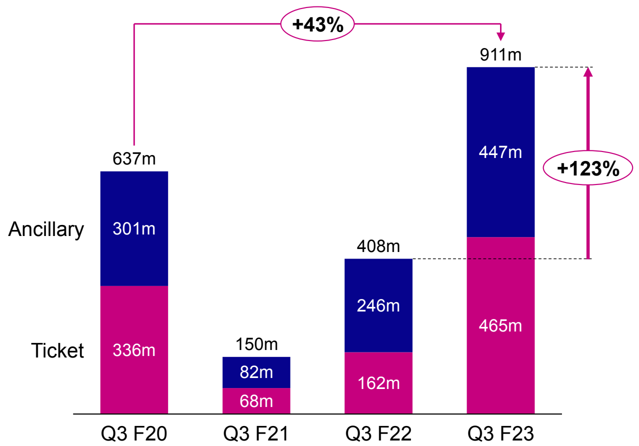
# Q3 F23 | REVENUE PERFORMANCE

## STRONG FARE ENVIRONMENT EXTENDS INTO WINTER 22/23

Revenue (€m)




| | |
|---|---|
| RASK | 3.73c (+3.6% vs F20) |
| RASK Ancillary | 1.83c (+7.45% vs F20) |
| RASK Ticket - flat, driven by lower load factor | |

- ✓ Capacity growth aligned to market dynamics
- ✓ Broader network enables more choice, better pricing
- ✓ Deploying advanced data pricing to more products, across more varied customer base
- ✓ Longer routes to/from Middle/Near East (counter-seasonal effect)
- ✓ Ancillary per pax € 36 (+20% vs Q3 F20)
- ✓ Ticket revenue at 51% of total revenue

wizzair.com

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ENDNOTES

[i] This was certainly true for the European economy, where the PMI survey compiled by S&P Global rose for the sixth consecutive quarter to an 11-months' high of 54.4 in April, providing clear evidence that even the banking crisis in March failed to halt the economic rebound from the 2022 energy shock following Russia's military aggression in the Ukraine, see: Martin Arnold, *"Strong eurozone business activity raises prospect of rate rise in May"*, Financial Times, 21 April 2023. In turn, the US economy showed persistent price pressures and resilience of the labour market, with wages rising reportedly by 1.2% during the first quarter of 2023 compared with 1% in Q4'2022. At the same time, the Core PCE Index was up by 4.6% year-on-year in March, following an upwards revision by 4.7% in February, see: Nicholas Megaw, *"Rise in US labour costs and inflation strengthen case for Fed rate rise"*, Financial Times, 29 April 2023. While the market had priced in a Fed rate cut as early as June, there is now a real risk of inflation staying for longer, with recent banking tremors having an impact on the wider economy implying credit contraction over the next quarters. As we had followed most of the leading US banks during the Q1'2023 results season, there was an extensive discussion on the implications of the recent banking crisis, with the CEO of Goldman Sachs, David Solomon, maintaining that there is "a higher risk of credit contraction as we are adjusting to higher interest rates" (Goldman Sachs Q1'2023 analyst call, 18 April 2023). The CEO of Citigroup, Jane Fraser, expects a "shallow recession" on the back of credit contraction, and remains most critical about the "shadow banking industry", which in her view requires more regulation (Citigroup Q1'2023 analyst call, 14 April 2023). In turn, the CEO of Morgan Stanley, James Gorman, expects a "light recession" and claims that "5-6% inflation is not dramatic" (Morgan Stanley Q1'2023 analyst call, 19 April 2023).

[ii] Mohamed El-Erian, *"Banking tremors leave a legacy of credit contraction"*, Financial Times, 10 April 2023.

[iii] This was eloquently discussed during the Q1'2023 analyst call of AkzoNobel on 25 April 2023, illustrated by the new CEO, Gregoire Poux-Guillaume, when discussing short-term pricing policy against customers trying to secure long-term volumes.

[iv] Key themes of interest in recent analyst calls can now be divided into major geopolitical and economic blocs, whether it is the US economy spurred by the Inflation Reduction Act, the EU competing through its own Green Deal and, more recently, EU Chips Act, or the implications of the reopening of China for Western companies. From a European perspective, senior management repeatedly pointed to "structural issues", whether it is customers of the chemicals industry "moving more global" (Martin Brudermüller, CEO of BASF, at the Q1'2023 analyst call on 27 April 2023) or whether US companies perceive "structural challenges in Europe", notably in the defence industry, energy and state budgets (Jane Fraser, CEO of Citigroup, Q1'2023 analyst call, 14 April 2023). When asked about potential acquisition targets among European banks in the wake of the Credit Suisse rescue effort, the CEO of Morgan Stanley, James Gorman, maintained that they have "no interest in European assets given the regulatory burden" and, even more pronounced, that they are "not getting into a rabbit hole because somebody is in distress" (Morgan Stanley Q1'2023 analyst call, 19 April 2023). While some European companies highlighted during the Q1'2023 results season the attraction of the North American market in greater detail (Holcim, Philips, Ericsson), others preferred to elaborate on their global diversification strategies to minimise geostrategic risk (TSMC, ASML, Intel, Tesla).

[v] For an interesting discussion of how contrarian investors got puzzled given current recession fears, see: Katie Martin, *"The contrarian dilemmas in markets for 2023"*, Financial Times, 18 February 2023. Others maintain that this is the time for active investors to differentiate themselves against passive strategies (Dan Taylor, *"The investing tide is shifting back towards active strategies"*, Financial Times, 17 February 2023).

[vi] The CEO of ABB, Björn Rosengren, described his own surprise of the strong Q1'2023 performance in terms of "almost everything went right for us" (ABB Q1'2023 analyst call, 25 April 2023).

[vii] The CEO of Nestle, Mark Schneider, outlined that "European consumers held up better than expected" (Nestle Q1'2023 analyst call, 25 April 2023), while the CEO of AkzoNobel, Gregoire Poux-Guillaume, also pointed to the fact that volumes and pricing were better than expected as "Europe was resilient" (AkzoNobel Q1'2023 analyst call, 25 April 2023).

[viii] There is a broad recognition of the limits for further price increases, even among some of the premium segments (Harald Wilhelm, CFO of Mercedes Benz Group, at the Q1'2023 analyst call on 28 April 2023), which is combined with ongoing supply chain issues, excess inventory and falling demand reflected in lower order intake (Trelleborg Q1'2023 analyst call, 27 April 2023). The greatest uncertainty, however, comes from significant wage increases starting in Q2'2023, which will have a material impact on companies' P&L going forward (A1 Group, KPN, AkzoNobel), with some

companies announcing, at the same time, major cost savings and headcount reduction programmes in Q1'2023 (Ericsson, BASF, Trelleborg). For an interesting discussion on wage inflation, see: Delphine Strauss, *"Global economy: will higher wages prolong inflation?"*, Financial Times, 1 March 2023.

[ix] John Plender, *"Companies may now be more resilient to inflation shocks"*, Financial Times, 29 April 2023. It is also indicative that Big Tech companies of the US (Alphabet, Amazon, Microsoft and Meta) managed to achieve a strong economic recovery in Q1'2023 – against fairly downbeat market expectations following the depressed Q4'2022 levels – a combination of orders from cloud customers picking up, heavy cost cutting and headcount reductions and renewed enthusiasm about generative artificial intelligence, see: Richard Waters, Elaine Moore and Patrick McGee, *"Big Tech earnings resilient as sector gears up for AI boom"*, Financial Times, 29 April 2023. For a fascinating academic analysis about the growing importance of intangibles, see: Jonathan Haskel and Stian Westlake, *Capitalism Without Capital. The Rise of the Intangible Economy*, Princeton University Press, 2018.

[x] Mohamed El-Erian, *"Banking turmoil intensifies the need for better Federal Reserve policymaking"*, Financial Times, 20 March 2023.

[xi] Ian Harnett, *"The financial turmoil is not over"*, Financial Times, 3 April 2023. While Credit Suisse's downfall was perhaps only a question of time, the attack on Deutsche Bank in the wake of the recent banking turmoil was a clear sign that investors were looking for other weak links in the system even among the large banks (Olaf Storbeck, *"Deutsche Bank says it was hit by a 'speculative attack' during turmoil"*, Financial Times, 27 April 2023). Major US banks had helped to prop up First Republic to prevent bankruptcy but, at the time of writing, and following massive deposit outflows after the March 10 collapse of Silicon Valley Bank leading to a 97% loss of share value, JPMorgan Chase acquired most of First Republic Bank after the regulator had approached a number of financial institutions (Brooke Masters, Stephen Gandel and James Fontanella-Khan, *"JPMorgan to acquire First Republic's deposits as US regulators step in"*, Financial Times, 1 May 2023).

[xii] It was interesting to follow the relevant debate among major US banks when reporting their Q1'2023 results, as they insisted that there is "no need for revamp of the entire system", even under new Basel IV capital requirements, as the higher rates for longer simply "undressed those businesses being unprepared" (Jamie Dimon, CEO of JPMorgan Chase, Q1'2023 analyst call, 14 April 2023). For the CEO of Citigroup, Jane Fraser, the main lesson of the regional banking meltdown in March was that "prudent asset-liability management is absolutely paramount", with the cornerstone of its business model being the institutional deposit base (Citigroup Q1'2023 analyst call, 14 April 2023).

[xiii] While the CEO of JPMorgan Chase, Jamie Dimon, considers only the real estate industry to be exposed to credit limitations and "not the wider economy" (JPMorgan Chase Q1'2023 analyst call, 14 April 2023), industry statistics paint a somewhat different picture (S&P Global, *Global Debt Leverage: Is a Great Reset Coming?*, 13 January 2023), while most of the critical questions by analysts were aimed at banks' exposure to commercial real estate. For the significant decline of European commercial real estate dealmaking, see: Joshua Oliver, *"European commercial real estate dealmaking falls to 11-year low"*, Financial Times, 27 April 2023.

[xiv] Ian Harnett, *"The financial turmoil is not over"*, Financial Times, 3 April 2023.

[xv] For a very convincing argument in this respect, see: Philip Coggan, *"Get ready for the great unwinding"*, Financial Times, 11 April 2023. For a very insightful analysis of the shortcomings of US rules-based regulation, see: Richard Bookstaber, *"US approach to financial regulation is set up to fail"*, Financial Times, 1 May 2023.

[xvi] For new guidance from the US Financial Stability Oversight Council, see: Colby Smith and Brooke Masters, *"US regulators outline new rules to toughen financial oversight of non-banks"*, Financial Times, 21 April 2023.

[xvii] Jennifer Hughes, Nicholas Megaw and Madison Darbyshire, *"US markets watchdog plans biggest overhaul of stock trading in nearly 20 years"*, Financial Times, 15 December 2022. For institutional resistance to the latest SEC proposal, see, among others: Jennifer Hughes and Nicholas Megaw, *"Investors join opposition to SEC stock market reforms"*, Financial Times, 3 April 2023.

[xviii] For an interesting summary of recent regulatory initiatives of the SEC as well as agency competition between different US regulators, including the Commodity Futures Trading Commission (CFTC) and the Federal Deposit Insurance Corporation (FDIC), see: Dennis Kelleher, *"Where regulators could reform Wall Street in 2023"*, Financial Times, 10 January 2023. Other relevant SEC reforms include the requirement of swing pricing for all mutual funds, see: Eric Pan, *"SEC's reforms to mutual funds will hurt investors"*, Financial Times, 13 April 2023 and, in the wake of the collapse of several high-profile crypto companies in 2022, to toughen custody rules on crypto, see: Jennifer Hughes, *"SEC pushes for tougher custody rules on assets including crypto"*, Financial Times, 16 February 2023. Naturally, we can only focus on some of the key initiatives in this respect.

[xix] For discussion on the shortcomings of the incoming EU crypto regulation, see: Martin Arnold and Scott Chipolina,

*"European Central Bank official warns of 'gaps' in forthcoming crypto rules"*, Financial Times, 6 April 2023, and for UK crypto regulation competing with the EU, see: Scott Chipolina, *"Britain's new crypto plans step up competition with EU regulations"*, Financial Times, 3 February 2023.

[xx] Nikou Asgari, *"EU faces last-ditch challenge from exchanges over trading reforms"*, Financial Times, 18 April 2023.

[xxi] Nikou Asgari, *"EU stock trading plans risk hurting small investors, warns Euronext CEO"*, Financial Times, 5 April 2023.

[xxii] https://www.lazard.com/research-insights/lazard-s-review-of-shareholder-activism-2022/

[xxiii] https://www.lazard.com/research-insights/shareholder-activism-update-early-look-at-2023-trends/

[xxiv] One example for a smaller company receiving mainstream press coverage is that of Luxembourg-based real estate company Vivion, following the attack by short seller Muddy Waters after accusing the company of using "bond sale proceeds to unduly enrich themselves" and inflating the true value of their assets (Robert Smith and George Hammond, *"Muddy Waters takes aim at property company Vivion"*, Financial Times, 15 December 2022). While there has been some controversy to what extent short sellers are a real force for change, Muddy Waters has been legendary in exposing accounting tricks and suspicious related-party loans and transactions in smaller companies. For a most insightful discussion of the changing trading environment for short sellers given higher interest rates, see: Laurence Fletcher, *"End of 'fantasy' stock market brings relief and pressure for short sellers"*, Financial Times, 14 December 2022. One example for a small company being attacked despite its majority state control is Austrian utility EVN, which was approached by Petrus Advisors in mid-December 2022, confirming the general trend of more activist calls for divestitures and Board changes. While London-based Petrus focuses predominantly on the German-speaking universe, there is no doubt that the debt of enquiry and multiplier effect of its campaign for mainstream institutional investors has massively improved and, certainly for the neutral observer, there are many valid points, see the list of questions raised at the EVN AGM in early February, including accounting, employee and remuneration related as well as valuation enquiries for real estate, derivates, CO2 emission certificates and EVN's arts collection (in German only): https://petrusadvisers.com/media/evn_agm_fragenliste_vf.pdf

[xxv] Peggy Hollinger, *"Danone lawsuit could be testcase for new war on plastics"*, Financial Times, 18 January 2023.

[xxvi] For a renewed campaign by Dutch shareholder activist Follow This, supported by Edmond de Rothschild AM, Degroof Petercam AM and Achmea AM, to force the largest Western oil companies (BP, Shell, ExxonMobil and Chevron) to reduce their emissions more aggressively this decade, see: Myles McCormick and Tom Wilson, *"Activist Group Follow This launches climate campaign against Big Oil"*, Financial Times, 19 December 2022. The fact that NGOs are now taking a much more concerted effort at company AGMs was vividly shown at last year's AGM of Austrian energy and chemicals company OMV, with the Q&A session lasting more than six hours and questions going at the very heart of OMV's claim towards a green transition (OMV AGM, 3 June 2022). For a list of questions from the Austrian Shareholder Association (IVA), notably on issues of internal reporting, supply chains and ESG reporting, see: https://www.omv.com/services/downloads/00/omv.com/1522218668242/ohv-2022-iva-focus-questions-2022.pdf

[xxvii] This was best witnessed in the latest campaign against Nestle by a group of institutional investors, chaired by responsible investment charity ShareAction and signed by several public pension funds, despite the company's disclosure of its product portfolio in terms of healthy food ahead of this year's AGM on 20 April (Alistair Grey, *"Nestle investors warn of 'systemic risk' from unhealthy foods"*, Financial Times, 20 April 2023). At its FY2022 analyst call on 16 February 2023, the CEO of Nestle, Mark Schneider, responded to the enquiry from the Goldman Sachs analyst how the company makes sure not to become too fixated about the percentage of healthy food through its "Good for You" campaign, that they make everything possible to reduce the proportion of sugar and saturated fats but that there is also a limit of what they can do in terms of keeping their food products fresh.

[xxviii] Brooke Masters, *"BlackRock chief Larry Fink pressured to resign over ESG 'hypocricy'"*, Financial Times, 7 December 2022. The campaign was led by a small London-based hedge fund, Bluebell Capital Partners, which had gained attention through its previous track record from large companies such as Richemont, Danone and Solvay.

[xxix] For the latter, see: Sylvia Pfeifer and Leila Abboud, *"Airbus drops deal with Atos digital unit after pressure from Chris Hohn"*, Financial Times, 29 March 2023.

[xxx] For Elliott's stake building in EV battery parts supplier Dai Nippon Printing, following previous campaigns against Toshiba and SoftBank, see: Leo Lewis and Kana Inagaki, *"Elliott builds activist stake in 146-year-old Japanese conglomerate"*, Financial Times, 24 January 2023. There was also wide coverage of a short seller's report from Hindenburg Research, alleging India's Adani Group to have engaged in stock manipulation and accounting fraud. While Adani managed to get support from its anchor investors through a $2.4bn share sale, this publication had clearly caused damage, with leading institutions such as Norway's sovereign wealth fund having reportedly reduced its

positions in Adani companies because of risks of potential corruption, environmental damage and human rights abuses (John Reed, Hudson Lockett and Richard Milne, *"Gautam Adani pulls off $2.4bn share sale despite short seller report"*, Financial Times, 31 January 2023). Among Western companies operating in India, TotalEnergies, which has a renewables joint venture with Adani, was asked by the Barclays analyst whether it has "changed its view" given latest events (TotalEnergies FY2022 analyst call, 8 February 2023).

[xxxi] Some companies pointed to continuing supply chain disruptions as a main reason for lower order intakes (Fagerhult, Trelleborg) while others explained in detail how they try to "smooth" supply chains (ABB, Tesla, Ericsson). Given the renewed inventory build-up in Q1'2023, the CFO of Renault Group, Thierry Pieton, explained that 50,000 cars remained incomplete by the end of Q1'2023 because of shortages of electronic components, describing their delivery as being "erratic", and, as customers have to wait for their car delivery several months, saying that "our sweet spot is two months of order intake and two months of inventory" (Renault Group Q1'2023 analyst call, 20 April 2023). In the car industry, despite the wider debate about the geopolitical implications of access to rare metals, the CEO of Tesla, Elon Musk, maintained that the real limit is more on commodity refining capacity less on mining, with Tesla having built their own refining facilities (Tesla Q1'2023 analyst call, 19 April 2023).

[xxxii] Rana Foroohar, *"China, America and why not all growth is equal"*, Financial Times, 1 May 2023, quoting US national security adviser, Jake Sullivan, that "our objective isn't autarky, it's resilience and security in our supply chains." At its first Investor Day, Tesla elaborated in great length how they are trying to improve supply chain management through "dual sources, simplified supply chains and strong vendor relationships" (Tesla 2023 Investor Day, 1 March 2023). At the same time, Tesla is insourcing increasingly, highlighting, for example, its ambition to increase its share in global wafer capacity from 0.5% in 2023 to 5% in future (CEO Elon Musk).

[xxxiii] In its recent report on foreign direct investment, the IMF noted that there has been a significant decline in investment between the US and China since 2015 as both countries perceive each other increasingly as strategic rivals, with hot money and bank lending between the two economies declining by 15% alone. Interestingly, in a simulation of potential efficiency losses based on a 50% reduction in investment flows between the US and China, the IMF found that the US would be least vulnerable (less than 1% of GDP), with Asian emerging economies outside China being most at risk (up to 6% impact on GDP), see: Chris Giles, *"'Friendshoring' is a risk to growth and financial stability, warns IMF"*, Financial Times, 5 April 2023.

[xxxiv] *Gartner Supply Chain Top-25 for 2022*, https://www.gartner.com/en/supply-chain/trends/supply-chain-award-winner-2023-procter-gamble. Among the top-10 of the 2022 Gartner list are three computer (Cisco, Lenovo and Microsoft), two semiconductor (Schneider Electric, Intel), three consumer goods and food (Colgate-Palmolive, PepsiCo and Nestle) and two pharmaceutical companies (Johnson& Johnson, Pfizer). Other research included the New York Federal Reserve's Global Supply Chain Pressure Index, which looks at port backlogs and freight costs over a period of 25 years, showing that constraints on moving goods around the globe peaked in late 2021 (Andrew Edgecliffe-Johnson, *"Companies race to work around choke points in world trade"*, Financial Times, 17 January 2023). Similarly, a report published by the McKinsey Global Institute in November 2022 found that flows of goods have not only recovered strongly after the pandemic, but they are also led by intangibles, services and human skills, underlying structural changes and secular trends despite geopolitical decoupling (Martin Wolf, *"Global capitalism: There's life in the old dog yet"*, Financial Times, 18 January 2023).

[xxxv] Despite the US Chips Act, ASML pointed to a significant upside in infrastructure, communications, energy and EVs in China, given that "the semiconductor base for the mature, mid-critical (less advanced) market in China is simply not there" (Peter Wennink, CEO of ASML, at the Q1'2023 analyst call, 19 April 2023). For most Western car manufacturers, cutting ties with China "would be unthinkable", as the CEO of Mercedes Benz Group, Ola Källenius, was recently quoted (Laura Pitel, *"Mercedes-Benz chief says cutting China ties would be 'unthinkable'"*, Financial Times, 30 April 2023). Even aerospace & defense companies were pinning their hopes on the re-opening of China, although "significant supply chain improvements are not expected until 2024" (David Coulhan, CEO of Boeing, at the Q1'2023 analyst call, 26 April 2023).

[xxxvi] There has been extensive coverage on Apple and its attempt to replace some of the Chinese supply chains with new Indian production lines, although this remains largely reduced to labour intensive Final Assembly, Test and Pack (FATP), with components essentially flown in from China and then assembled mostly by Taiwanese companies. The key issue in India appears to be the lack of the required skill sets, migrant labour pools, infrastructure and a supportive government that makes China so attractive to Apple (Patrick McGee, *"What it would take for Apple to disentangle itself from China"*, Financial Times, 18 January 2023). Still, there has been a lot of effort made to diversify supply chains out of China in recent months, which airline companies can track in shifting booking patterns as the CEO of

Lufthansa, Carsten Spohr, pointed out already at their Q3'2023 analyst call on 27 October 2022. For a more detailed discussion of Siemens planning the diversification of supply chains into Indonesia, Vietnam and Thailand, see: Mercedes Ruehl and Patricia Nilsson, *"Siemens scours south-east Asia for deals to diversify from China"*, Financial Times, 14 March 2023.

[xxxvii] Tesla's sudden price cuts in early 2023 following fierce competition by Chinese EV manufacturers has been a good example, although it had to be reversed only a few weeks later, despite CEO Elon Musk still maintaining that "this is a good time to increase our lead" (Tesla Q1'2023 analyst call, 19 April 2023). While presented as being a constituent part of its changing business model towards a subscription-based software company, supported by direct sales including spare parts and servicing (which has not been the case so far), this episode clearly illustrates that this is a race for ramping up volumes – and in this respect the Chinese are a serious competitor not just in their home market.

[xxxviii] Anne-Sylvaine Chassany, *"China is back, bringing profit and perplexity for western business"*, Financial Times, 21 April 2023. Germany's chemicals conglomerate BASF certainly made the headlines when announcing a EUR 10bn investment in China in summer 2022, triggering a wider debate about relocation of European businesses elsewhere, but others followed suit, perhaps in a more humble way, but with a clear gesture to their Chinese hosts (see, Volkswagen recently announcing to invest EUR 1bn to build an innovation centre in China, following a EUR 2.4bn venture with Chinese chip designer Horizon Robotics last year).

[xxxix] Anjli Raval, *"The shock of mass lay-offs is only the beginning for companies"*, Financial Times, 30 January 2023.

[xl] Taylor Nicole Rogers, *"US companies turn to contract workers in face of recession fears"*, Financial Times, 21 December 2022.

[xli] Gillian Tett, *"Corporate America is struggling to adapt to Gen Z"*, Financial Times, 10 February 2023.

[xlii] Nicholas Bloom, Ruobing Han and James Liang, *How Hybrid Working From Home Works Out*, NBER Working Paper 30292, Cambridge, MA, revised January 2023.

[xliii] There has been an extensive debate as to whether labour has gained more power in the wake of the pandemic-induced higher inflation and labour shortages but statistics for global real wages seem not to confirm this despite headline-grabbing numbers of wage increases of 10% and more (Sarah O'Connor, *"Has the pendulum really swung from capital to labour?"*, Financial Times, 20 December 2022).

[xliv] This point was extensively made by the CEO of Ford, James Farley, at the FY2022 analyst call on 2 February 2023. He estimated that the instability of supply chains added at least $1bn in additional costs in 2022.

[xlv] For the relevant coverage in the financial press, see: Camilla Cavendish, "*Tempting back older workers means ditching business as usual"*, Financial Times, 7 February 2023 and Phyllis Papadavid, *"The number of non-active young people is a global problem"*, Financial Times, 5 April 2023.

[xlvi] Peter Campbell, *"Europe's autoworkers will pay the price for electric vehicle push"*, Financial Times, 8 March 2023. At its first Investor Day, Tesla discussed extensively to what extent it is currently rethinking the entire manufacturing process, trying to reduce costs through structural sub-assembly, space-time efficiency and operating density (Tesla 2023 Investor Day, 1 March 2023).

[xlvii] The CEO of American Airlines, Robert Isom, described the change of network, partnerships and fleet post-pandemic as being "material", which is certainly an understatement given the herculean task (American Airlines Q4'2022 analyst call, 26 January 2023). Supply chain problems at Boeing and Airbus were extensively discussed in autumn, with the CEO of Airbus, Guillaume Faury, saying that "managing the supply chain is the highest challenge today" (Airbus CMD 2022, 23 September 2022) and the CEO of Boeing, David Calhoun, claiming that "supply chain issues will not get easier in the near term" (Boeing Q3'2022 analyst call, 26 October 2022).

[xlviii] US airlines had pointed out early on that a "different type of seasonality" has evolved post-pandemic, forcing structural changes in terms of cost convergence and supply constraints while, at the same time, implying the potential for higher margins (United Airlines Q4'2022 analyst call, 18 January 2023). The new "travel behaviour" is described as being driven by hybrid workplaces, blurring business and leisure bookings (Delta Air Lines Q1'2023 analyst call, 13 April 2023).

[xlix] Southwest Airlines Q3'2022 analyst call, 27 October 2022. Among the four major US airlines, Southwest was mostly exposed to the winter storms in late December which, however, it managed to restore by the end of Q1'2023, which is a reflection of how strong demand currently is, getting close to the 2019 level (Southwest Airlines Q1'2023 analyst call, 27 April 2023). For a discussion of the constraints caused by limited aircraft availability and utilisation, see: American Airlines Q3'2022 analyst call, 20 October 2022.

[l] This was outlined by the CEO of United Airlines, Scott Kirby, at the Q1'2023 analyst call on 19 April 2023, saying that "you got to control what is in your hands" but, at the same time, anticipating a "mild recession and soft landing" when

judging by the bookings.

[li] Interestingly, all major US airlines have structured their quarterly reports nowadays along those key pillars of the changing business model, with various senior executives including the Chief Operating Officer going through these strategic themes in great detail.

[lii] Among European airlines we had closely followed in recent months, IAG appeared to be most behind in the recovery curve, with business bookings being back to 65% of 2019 levels in volume terms (BA by 56% and Iberia by 72%) at the end of 2022 (IAG Q4'2022 analyst call, 24 February 2023). In turn, unit costs were estimated to be higher by 10-15% in 2023 compared with 2019, while the full fleet size will be back by 2025 only (Nicholas Cadbury, CFO of IAG).

[liii] At its FY2022 analyst call on 3 March 2023, Lufthansa maintained that it "deliberately pursues conservative capacity management" to achieve higher yields and improve profitability, although corporate travel is expected to be only at 70% of 2019 levels by the end of 2023 (Carsten Spohr, CEO of Lufthansa).

[liv] While WizzAir has extended flights to the Middle East, the Caucasus and Central Asia, the CEO, Jozsef Varadi, emphasised that "this year and next, cost is the name of the game", pointing to their strategic decision to fly new aircraft and achieving customer loyalty through low costs (WizzAir Q3'FY2023 analyst call, 26 January 2023). In turn, Ryanair has been particularly positive about its summer 2023 bookings, with capacity being at 125% of the pre-Covid level (Ryanair Q3'FY2023 analyst call, 30 January 2023).