European bank CDS showing no contagion

We have no expertise in Turkish economics or politics, but do have an idea of what to look for if the Turkish currency crisis has a contagion effect similar to what happened in Greece in 2011-12. First, for perspective, our Asset Class Strategist Brian Reynolds noted today that Turkish debt-to-GDP is about half of what Greece’s was at the beginning of the European Debt Crisis. The fear in the marketplace is that the historic drop in the Turkish lira makes non-Turkish debt unaffordable to service, which could lead to a contagion effect on European banks with significant exposure to Turkey. Thus far, the crisis in Turkey has not led to a significant move in the credit derivatives for European banks, and the weakness in the US markets more likely is a result of being in tactical no-man’s land.

European bank CDS not showing contagion. We track perceived fear in the European banks through the Markit iTraxx Europe Senior Financial Index (SNRFIN), which tracks 30 equally weighted investment-grade credit default swaps (CDS) of European institutions. If the fear in the marketplace centers on a possible contagion into European banks, it makes sense this index will be the best gauge of increased stress. Although the SNRFIN is up from a record low earlier this year, it is far from showing significant stress. The index is roughly at the same level as in recent months, and well below the Emerging Currency Crisis in 2016, or the multi-year Greece-led European Debt Crisis in 2011-12 (Figure 1).

**Figure 1: European Bank CDS not showing contagion effect**

Despite fear of Turkish driven contagion, the index tracking 30 equally weighted investment Grade Credit Default Swaps (CDS) in Europe remains well below 2016 much less 2011.

**Summary** – Over the past few weeks, we have highlighted the increased risk of near-term volatility that should create a better entry point for a year-end move toward our 2018 SPX target of 3,200. The Turkish currency crisis provides an excellent excuse for a temporary pullback, but thus far has shown no reason for us to adopt a more intermediate-term defensive position.
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Global Stock Ratings (as of 08/13/18)

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