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Banking Update

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The headlines in the banking sector continue to stoke the fears of investors but beneath the headlines stabilizing forces are at work. Just one week after US officials backstopped Silicon Valley Bank depositors and helped orchestrate a deal to bailout First Republic, Swiss authorities engineered a deal to save struggling Credit Suisse. Looking at each of these situations we can see the causes are unique to the individual banks not the cause of a systemic banking problem.

Silicon Valley Bank, as I have mentioned in other notes, mismanaged their duration risk. The bank which focused on the fast-growing technology sector, particularly start-up companies, grew very quickly in a low interest rate environment. When rates rose and business slowed, the bank could not meet its short-term obligation because it owned long term government bonds. Investors fear led to a run on the bank and eventually SVB was forced to close with the Treasury department lifting the cap on government insured deposits and backing depositors.

Signature Bank of NY made a large bet on crypto currencies. The bank was accepting crypto from depositors and as rates rose, crypto came under pressure and like SVB experienced a run-on deposits.

Like the previous two mentioned bank failures. First Republic had some issues in meeting its day-to-day operations and was bailed out by an injection of $30 billion from some of the largest banks in America.

Turning our attention to Credit Suisse, we see an iconic financial institution that had been badly mismanaged for years, and its measly sale price reflects its fall from grace. Valued at $8.5 billion at market close on Friday, Credit Suisse sold for significantly less than half that. Once considered one of the greatest banks in the world, the Swiss authorities had to offer UBS $108.8 billion in liquidity to take over the bank. Again, it was mismanagement that led to a run-on deposits that forced the Swiss government to act.

Global stock markets, particularly the banking sector, have come under pressure as this current crisis plays out. However, this is not 2008 or even the tech bubble in 2000. The banking system is not overly leveraged with loans against overpriced assets but rather a few banks made poor bets that should not have been made and went against them. In addition, governments have acted quickly to isolate the bad banks. SVB has failed and we may see a few more midsized banks close their doors, creating a crisis of confidence, not a system wide failure. We have stated and continue to believe volatility in equities will remain elevated in the short term. As Warren Buffett said, the time to buy equities is when everyone is afraid.

The Federal Reserve meets this week, and the street is expecting a 25- basis point rate hike, down from a 50-basis point hike priced in a few weeks ago. Whether the Fed pauses its rate hiking policy or just slows its pace of hikes, the uncertainty of the FOMC move will be removed from the market, giving investors more time to let the dust of the current banking situation settle. As a reminder, the only fund we have with direct exposure to the financial sector is Low Volatility and that fund holds the largest names in the sector, likely beneficiaries of the move to safety. In addition, it appears large cap tech because of their strong balance sheets is being viewed as a haven for assets. Also benefitting from the current move away from financials.

Below are some links to articles addressing the current situation.

Silicon Valley Bank: Here's what happened to cause it to collapse - MarketWatch

Private-Equity firms Will Bid on SVB's Assets | Barron's (barrons.com)

First Republic Bank bonds, stock rally as big banks announce $30 billion pledge - MarketWatch

UBS is buying Credit Suisse in bid to halt banking crisis | CNN Business

What’s next for stock market as Fed weighs bank chaos vs. inflation fight - MarketWatch

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