March 16, 2023

Good Afternoon,

Market volatility has intensified over the last week due to the failure of Silicon Valley Bank (SVB) and Signature Bank. What is going on and what are implications of these bank closings? We'll try to address the questions in this longer-than-normal update. For purposes of explanation, we'll focus on SVB. (Signature Bank's circumstances are very similar.)

SVB was a regional bank in California that had many tech start-up companies and venture capital firms (as well as individuals) as customers. As such, they had very large depositors concentrated in the tech industry. Like other banks, SVB would use the deposited cash to make loans and purchase securities as reserve assets when customers needed to withdraw funds. SVB invested in long-term treasury bonds and those assets fell in value when interest rates rose sharply last year. In addition, as the business environment for tech firms weakened, they made sizeable withdrawals to fund operations. Venture capital firms did the same. SVB warned that the drop in value of their treasury holdings combined with the large withdrawals of cash were having a negative impact on their ability to meet withdrawals. This, in turn, caused a run on the bank (withdrawals exceeding reserves) and regulators seized the assets. The government guaranteed depositors would have all their funds available, even though FDIC insurance only covers deposits up to $250,000. The government action likely prevented a serious potential nationwide banking panic.

While depositors have been made whole, shareholders of SVB were wiped out. Management has also been fired and will be on the hotseat as Congress begins investigating the failure. We believe an examination of the events will reveal a combination of culprits, including a loosening of regulations for small and mid-sized banks in 2018 under the Trump administration, weak enforcement practices of current bank regulators, poor judgment of SVB management, and sharply rising interest rates that caused normally stable US Treasury securities to drop sharply in value.

Is the SVB failure an indication of a threat to the banking system as a whole? We don't believe so as the larger, name brand banks are more highly regulated and subject to Fed "stress tests" on a regular basis. Their reserve requirements are also stricter. However, confidence has been shaken and we've seen that in the share price of regional banks over the past week. Will the SVB failure give the Fed reason to pause or stop its rate hike plans? We will find out next week when the Fed meets and announces its decision. The situation has certainly complicated their deliberations. In the meantime, inflation data continue to point to a slowdown in price increases across most goods and services.

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http://www.commonwealth.com/RepSiteContent/weekly_comm/commentary_redirect.htm

As always, if you would like to discuss this or anything regarding current market conditions or your portfolio, feel free to contact me at any time.

Happy St. Patrick's Day!

Wade

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