Stirling Bridge
Wealth Partners, LLC

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No sensible man watches his feet hit ground. He looks ahead to see what kind of ground they'll hit next. ~Ernest Haycox

This month we shall dive into the recent (ongoing?) banking troubles. Truth be told, we were entirely convinced that this month's quotation would center around the word, "lost" – as in "All was lost," by Milton or "Men have lost their reason," by Shakespeare. But in perusing our musty and well-used Bartlett's Familiar Quotations, we stumbled across Mister Haycox.

Ernest Haycox served in WWI as a teenager. Afterward he became a writer of pulp serials and novels with topics ranging from the Old West to the Revolutionary War. His short stories were featured in popular magazines of the day such as Collier's Weekly and The Saturday Evening Post. His titles were turned into movies during Hollywood's Golden Age by acclaimed directors such as John Ford and Cecil B. DeMille. One of those movies, Stagecoach, turned John Wayne into a star. Haycox was also a favorite writer of a more famous Ernest with the surname Hemingway.

At any rate, the sensible man of whom Haycox writes above stood in marked contrast to the myopic nature of investors, business leaders, elected officials, and unelected officials – before, during, and after the recent messes. But before we launch into just criticism and warning, we must be direct with sincere reassurance. There is currently NO REASON the troubles at the latest list of ugly banking institutions must clatter their way out to other financials, sending us spiraling into the Dark Ages II. The negative effects will be felt and will perhaps tighten lending standards, thereby trimming growth or prompting recession. These latter effects are merely normal parts of a business cycle. Trees cannot grow to the heavens, after all.

Said differently, in the Great Recession there was one massive problem that spread over all global financial institutions – housing. Today's issues are real, but more idiosyncratic. Crypto here. Poor risk management there. Concentrated customer base here. Reporting missteps there. And it is the diverse nature of the recent problems that makes it less likely to become a systemic issue.

Astute readers (presumably all of you) will immediately protest that the proximate cause of at least a couple of the bank failures in March was deposit outflows, the Achilles' heel of all banks. True enough. Yet, ALL commercial banks have seen deposit outflows since last year. First, deposit balances at banks were artificially high since the juiced-up largess from the Federal government initiated during lockdowns. Second, also due to lockdowns and related policies, interest rates had to increase to fight inflation. Savers suddenly had more options for their dollars and pulled deposits to earn higher returns. And as of this writing, they still are pulling net deposits.

Still, failures need not become a disastrous daisy chain. With clicks of buttons or swipes on phones, most savers have sorted out their deposits in the past few weeks, ensuring that a larger percentage of deposits are under the FDIC $250,000 limit. Also, since those high-profile failures, the Fed has aggressively expanded its balance sheet. While still increasing interest rates in the front yard, they have effectively begun what has been called Quantitative Easing in the back yard. Banks suddenly have additional levers for short term financing.

Which brings us to the point of criticism. A cancer diagnosis requires more than a band-aid. In a similar vein, we continually accept band-aids on a system that needs drastic reform. For nearly 70 years, the Glass-Steagall Act helped prevent a Great Depression by forcefully separating commercial and investment banking. Within eight years of its repeal in 1999, the Great Recession was upon us. And the response to the Great Recession was one of bundles of balms and band-aids. Unlimited liquidity provided by the Fed? Check. The purchase of non-treasury securities by the Fed? Check. Federal ownership of private institutions? Check. And many others. Then in March of 2023 – arbitrarily cover ALL deposits without debate or an act of Congress? Check.

By their very nature, banks are extraordinarily different and more dangerous institutions than a bakery or car manufacturer. Even the best managed bank on the planet has the unenviable reality of too-long-dated assets (the loans they make) and too-short-dated liabilities (deposits). And even that mythical best bank on the planet, once enough depositors think otherwise, can be out of business in 24 hours. So, what to do?

Our take is to stop with the band-aids. We propose revisiting Glass-Steagall, updated for modern banking. We further propose requiring banks to keep 100% of reserves for non-interest-bearing accounts, thereby eliminating the need for FDIC coverage at all. Then, having no FDIC coverage at all for interest-bearing deposits, but with strict, conservative reserve requirements. Banks would be less levered. They would have to pay fairly for deposits. They would have to be better underwriters of loans. They would make more money from service fees, spurring competition for better service. Depositors would know going in that the entire reason they are receiving an interest rate at all is because they are taking risk. And because these interest-bearing accounts are no longer to be considered ultra-liquid, there could be contractual gates that limit runs (lock-up periods, maturity schedules, penalties, redemption percentage limitations, and the like).

In closing, we are not so foolish as to think any of our proposals will see the light of day in a debate. But we do hope some version of long-range planning can be done by Congress, perhaps suggesting we can be more like the sensible man in Haycox's short story above, focusing ahead, not down. For if we do not, perhaps we ought to have instead used a quotation from Napoleon. Writing in his memoirs after his exile to St. Helena and discussing the outcome of Waterloo, the former emperor wrote, "All was not lost until the moment when all had succeeded."

May we not wait until it is, in fact, too late to fix our damaged system.

Stirling Bridge Wealth Partners, LLC is fortunate to count many of you as clients. In the good times and bad, we remain committed to providing customized investment solutions and robust financial planning wrapped in a package of exceptional service. We thank each of you for your dedication to us and for your trust.

Sincerely
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