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The Stock Market and Banking in 2023

Most of this update on the banking and stock market was taken from many resources. I have paraphrased many sources the greatest of which is from Diego Colman contributing strategist at DailyFx. **Please read this in its entirety.**

I have shared with some of you that we are expecting a new high in the market this year. It has been tough to see, especially with the aggressive path the Federal Reserve is taking. Understand that expecting a new high and seeing one are two different things. For most of last year we had little exposure to stocks and our accounts did not see the losses the market provided. We currently still have low exposure to stocks and will not make any substantial change until our technical indicators warrant doing so. If we are going to look for a catalyst to new highs, the current banking issues that face our economy might be it.

The Federal Reserve has five general functions (3 below form https://www.federalreserve.gov/aboutthefed.htm)

- promotes the stability of the financial system and seeks to minimize and contain systemic risks through active monitoring and engagement in the U.S. and abroad;
- promotes the safety and soundness of individual financial institutions and monitors their impact on the financial system as a whole;
- fosters payment and settlement system safety and efficiency through services to the banking industry and the U.S. government that facilitate U.S. dollar transactions and payments

Bringing stability back to the financial system may just be enough of a reason for them to pause rate hikes.

Silicon Valley Bank (SVB) was shut down by regulators last Friday and put into receivership for insolvency. The California-based lender had been in business for about 40 years. They catered to a very specific clientele in the technology and healthcare startup sector.

After the pandemic interest rates were near zero percent to support the economic recovery. Tons of stimulus money was injected into or economy. SVB experienced exponential growth; with deposits soaring from $61.76 billion at the end of 2019 to $189.2 billion at the end of 2021.

As deposits outpaced loan issuance, SVB stashed the extra cash in bonds (Treasuries, mortgage-backed securities, etc.) to earn a return on capital, a common business model in the industry. However, the bank, allowed its investment portfolio to swell to 57% of total assets, well above the 24% average among U.S. lenders.

When inflation made an unexpected appearance last year the Federal Reserve responded forcefully, launching its most aggressive tightening campaign in decades with rates not seen in the last 15 years.   The rapid rise in interest rates caused bond prices to plummet, given their inverse relationship. This put SVB and now other banks, which have large amounts of fixed-income securities with massive unrealized losses.

If bonds are held to term, a fall in their price due to adverse rate movements during their lifespan is meaningless, they are only temporary unrealized losses, as the nominal value of the investment will be fully recovered at maturity if there is no default. The problem for banks arises when they are forced to offload their holdings at a loss because of an urgent need to raise capital.

With the economy in weak health and interest rates at their highest level in 15 years, companies are relying more on use of cash and taking no loans for smaller loans.

As withdrawals accelerated at SVB and (other banks,) they needed to sell off big chunks of their fixed-income portfolio at heavy losses. SVB declared a $1.8 billion write-down on the sale of $21 billion worth of securities and announcing that additional measures may be needed to raise capital. When it was all said and done, depositors had initiated withdrawals of $42.0 billion from the institution by the end of Thursday, creating a negative cash balance of nearly $1.0 billion and leading to insolvency and becoming the second-largest bank failure in U.S. history.

The Federal Reserve on Sunday adopted emergency measures to shore up the U.S. banking system and avert a broader crisis after the second-largest bank failure in U.S. history. To stem fears of contagion, the central bank established a funding program, backstopped by $25 billion from the U.S. Department of Treasury to support depository institutions facing liquidity issues.

Additionally. I know some of you bank with First Republic Bank, as do I and my Family. I have been in touch with our banker checking up on our accounts and gaining an understanding of what their exposure is given all that is going on in the banking community right now. I feel comfortable with their decisions, and if you click this link: https://www.bloomberg.com/news/articles/2023-03-16/us-pushes-first-republic-rescue-with-big-banks-after-stock-slump#xj4y7vzkg I hope you will start to gain some of that same confidence. We have not chosen to move or change any of our accounts.

Sincerely,

James W. Vassas Jr.