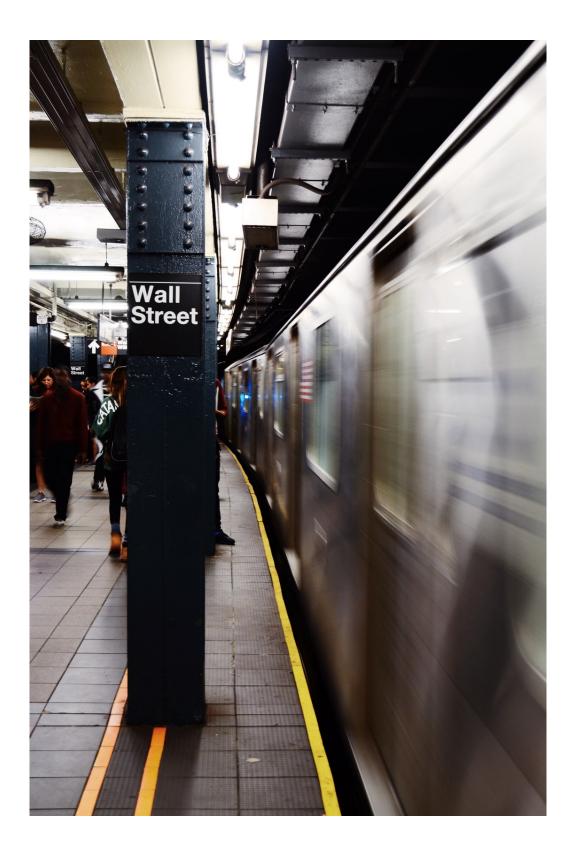


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Regulators intervene to restore confidence after the collapse of Silicon Valley Bank



- Silicon Valley Bank-parent SVB Financial has collapsed after running into liquidity issues
- The Fed has taken preemptive steps to restore confidence and prevent panic by earmarking \$25 billion for financial instability
- Clients of SVB will be able to recover their funds, even if they exceed the usual \$250,000 deposit guarantee
- The risk of a large US bank experiencing a capital or liquidity event like in 2008 is very remote

Last week, Silicon Valley Bank's decision to sell \$21 billion worth of bonds at an estimated loss of \$1.8 billion, surprised the market and triggered mass withdrawals by depositors, ultimately causing the institution to fail. Like many banks, SVB received an influx of deposits during the pandemic. The bank had invested cash in a batch of long-term, low-interest-rate bonds like US Treasuries, which are relatively low risk – if held until maturity. SVB was obliged to close these positions prematurely as depositors (a lot of tech start-ups that had burned through their cash) started to withdraw funds. Unlike other bulge bracket US banks, it appears that SVB had not started to shift exposure out of long-dated bonds and into cash (or equivalents) as the Fed embarked on its interest rate hiking campaign. The disruption caused by having to sell these securities before maturity in order to obtain liquidity highlights the challenges of this approach. Given that SVB had an investment grade credit rating, it also throws this classification into question.

The negative repercussions on financial markets came swiftly as investors started to contemplate just how much the securities banks own would be worth if they would be forced to sell. Banks are rarely forced sellers, however, with yields on the rise, US Banks are dealing with a loss of deposits. To combat this, they must increase their deposit rates at a faster pace than the increase in interest rates and in turn, this affects the earnings perspectives of the US bank sector.

Amid a broader equity sell-off, the financial sector was particularly hard hit, especially smaller players. For some market participants, the events raised spectres of the Great Financial Crisis, but we believe that the risk of a large US bank experiencing a capital or liquidity event like in 2008, is very remote.

One of the key reasons why the current situation differs from that of 2008, is that the Fed has taken preemptive steps to restore confidence and prevent financial panic by earmarking \$25 billion for financial instability. It assures that all clients of SVB will be able to recover their funds, even if they exceed usual \$250,000 deposit guarantee.[1] More broadly, the program will also be used to establish a credit line to prevent institutions facing similar financial problems from going under. The official communications highlighted that:

- The Federal Reserve Board will make available additional funding to eligible depository institutions to help assure banks have the ability to meet the needs of all their depositors.
- The Federal Reserve is prepared to address any liquidity pressures that may arise.
- The additional funding will be made available through the creation of a new Bank Term
 Funding Program (BTFP), offering loans of up to one year in length to banks, savings
 associations, credit unions, and other eligible depository institutions.

The SVB debacle shows that the Fed's tightening campaign is having an impact, even if the

economy has held up so far. Futures markets show investors believe the US central bank will ease off of its hiking campaign from here, and the stress seems to have tipped the pendulum in favour of bets for a 25bp hike at the next FOMC on March 21-22 (but let's wait for tomorrow's inflation print before drawing any strong conclusions). Prior to the SVB fall, markets were fearful that strong labour market data would compel the Fed to re-accelerate in its pace of hikes, once again adopting 50bp increases.

After SVB's downfall, the USD softened while S&P Indices announced that medical device company, Insulet Corp.,, would replace SVB in the S&P 500 Index.

Our managed portfolios had no direct exposure to SVB. However, we did hold ETFs tracking the S&P 500, but SVB made up a very small percentage of the overall index composition at 0.04%[2].

[1] For comparison, the \$250k backstop is similar to the "Fonds de garantie des dépôts Luxembourg" which guarantees that depositors are reimbursed up to a maximum level of EUR 100,000 per person and per bank in the event of a bankruptcy.

[2] As at the end of 2022

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