Richard Bernstein Advisors

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RBA Quick Insights

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Some thoughts on the banks

Breaking down the Silicon Valley Bank breakdown:

What's happening to Silicon Valley Bank is exactly what we warned about in a report from over a year ago, *The Biggest Risk to Portfolios Today* (rbadvisors.com). While the original report was written in the context of *investor portfolios* having concentrated Technology/duration exposure within their stock holdings and in their alternative investments, which added to the already heavy exposure to traditional fixed income duration, it is essentially the same issue that caused Silicon Valley Bank to fail.

Regarding liabilities, a large portion of their deposits were concentrated in Technology/venture capital/start-up clients who were forced to pull those deposits to cover operating costs as liquidity dried up and their growth slowed. On the asset side, the bank needed to sell investments to fund those withdrawals, but they had invested a significant portion of those deposits — unlike traditional banks who lend more of their cash out — in bonds, many of which were medium/longer maturity fixed-rate bonds. With the large rise in interest rates, those bonds became worth a lot less and selling them caused the bank to realize enormous losses which created a funding shortfall.

In essence, the bank's balance sheet was a concentrated bet on Technology/venture capital/duration (just as many investors' portfolios were last year), hitting it simultaneously from both sides of the balance sheet. This is exactly what happens when liquidity dries up.

Here's the bottom-line:

1. This is not a hair-on-fire event for the overall economy. It is for some banks, for the Technology sector, and for venture capital speculators, but the overall economy likely won't be ruined.

2. The whole point of Fed tightening is to slow the business of the banking sector. That's how tighter monetary policy gets into the economy. People oddly forget the Fed is the Central BANK!

3. Zero interest rates and 27% M2 money supply growth caused some VERY speculative behavior. Unfortunately, speculators rarely believe they are speculating and think there's a "new world order" of some sort. This cycle is now proving that misconception once again.

4. This isn't likely to be the end of venture capital/Technology/startup problems. Although there have been problems popping up, this is only the first to gain national attention.

5. RBA's positioning is very defensive relative to the speculative aspects of the market and the economy. Our portfolios are generally quite shielded from these issues, having sold out of Regional Banks and Global Financials last year, we are underweight banks in general.

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*RBA does not directly hold any Silicon Valley Bank securities but might have inconsequential positions held indirectly through the underlying portfolios of the registered investment companies in certain product offerings.