THE TYSON SMITH GROUP OF RAYMOND JAMES®

WEALTH MANAGEMENT INSIGHTS

MARCH 2024

BANKRUPT

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By Tyson R. Smith

The collapse of Silicon Valley Bank caught the attention of the entire world last year. SVB was the largest financial institution to fail since the financial crisis of 2008 and the third largest bank failure in United States history. Soon thereafter a handful of other names followed suite and were taken over by the FDIC to protect depositors. In my opinion, these institutions were mismanaged, and this whole mess could have...no SHOULD have been avoided. This was not a Credit Crisis like we experienced in 2008; where borrowers defaulted on their loans en mass. This was a failure of bank leadership to manage their internal assets appropriately during the economic environment in which they found themselves. To understand why I am so adamant in my opinion, let us first explore the basics of banking.

BREAKING [DOWN] THE BANK

When a bank is opened, a group of Investors come together to form an ownership group. These owners may intend to take their bank public at some point in time, or they may stay private and keep their shares closely held. No matter which structure they choose, the banking rules apply the same and each institution must follow the FDIC guidelines and rules in order to be an FDIC Insured entity.

Once the bank is open for business, the leadership will solicit depositors to use their institution for depositing funds into Savings Accounts, Checking Accounts, Money Market Accounts and their CD's. In exchange for holding this cash for their customers, the banks will usually pay a nominal rate of interest to the depositor as long as funds are in the accounts.

Behind the scenes, the leadership of the bank is watching the total amount of money brought in "on deposit", from which they will determine how much they can loan back out in the form of mortgages, car loans, home equity lines of credit, or business loans. Once this amount is determined, the loan officers go to work to find borrowers to whom they can loan funds. The bank however, will not be allowed to loan out 100% of the deposits they receive. They will be required to keep a healthy percentage available as liquid cash in order to fulfill depositors demands for cash.

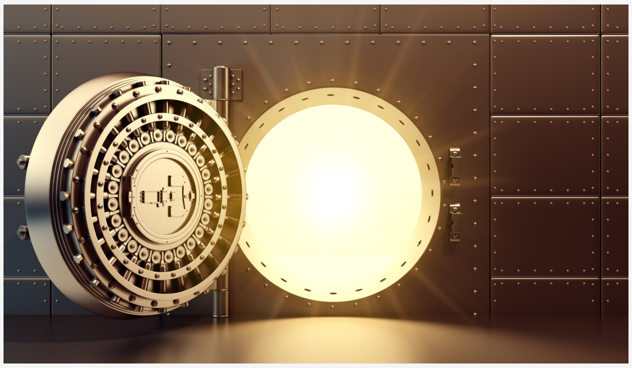
Those demands happen each time a depositor makes a withdrawal at an ATM machine, uses their Debit Card, or writes a check. This seems like a simple concept but there's a lot more that happens along the way.

To understand how this seemingly simple business structure collapse at SVB, let's put together a hypothetical scenario:

Let's pretend that we are starting our own bank and we manage to attract $100,000,000 in total deposits from customers. The FDIC will require cash on hand to be maintained at a certain percentage of total deposits. This is called the Reserve Ratio and it is not a static percentage. For our example, we're going to say our bank is require to maintain a Reserve Ratio of 10%; which is $10 million.

The remaining $90 million in deposits is thereby earmarked to be loaned out to borrowers in various types of loans....but those loans don't happen overnight or all at once. Those loan officers will take months or even years to write that much in loans to borrowers.

As all that money is waiting to be loaned out, the bank is allowed to invest it. The investments held in a banks portfolio are highly scrutinized by the FDIC and can negatively affect the strength rating of the bank if not properly handled. Holding it as cash won't make the bank any money, so banks will reinvest those deposits temporarily to gain some interest (and income).



The investments are assessed according to their risk profile and will be categorized as either Tier 1, Tier 2, or Tier 3 investments. Those investments are assessed based upon the Basell III standard and ...... well, this isn't important for our purposes here. Let's just say that Tier One Capital is more conservative and the regulators like to see more Tier 1 holdings and fewer Tier 2, and Tier 3 holdings. Tier 1 are more conservative and more stable, with much less risk. You'll probably find it of no surprise that U.S. Treasuries are categorized at Tier 1 investments. Banks portfolio managers will therefore typically buy a lot of Treasures with their cash as it sits waiting for a Loan Officer to lend it out at a higher rate.

BANKING 101

In keeping with our hypothetical example; let's assume our lenders managed to get $50 million loaned out. There is also $10 million sitting in cash, which leaves another $40,000,000 invested in Treasuries. In order to get a higher rate of return, those bankers will buy some Treasures with longer maturities. (Longer maturities typically pay higher rates of interest that shorter maturities). This creates a problem when rates rise though.

As I wrote in my "Bonds" publication in the summer of 2022, secondary market valuations of fixed income securities will move in direct opposition to the direction of interest rate changes. Simply put; If prevailing interest rates go down, the secondary market value of bonds go up; If rates go up, bond values go down...and the longer the bond, the more it moves.

A 2 year Treasury will fall very little in a rising rate environment. A 20 year treasury could fall precipitously, if rates shot up rapidly. So, $40,000,000 sitting with an average maturity of 15 years, during a rising rate environment would be very bad for secondary market values. Furthermore, if any of those bonds were required to be sold in order to generate cash for a loan that was written, or to replenish the 10% required Reserve Ratio, it would be sold at a loss and reported to shareholders, depositors and the FDIC.

By the way, these are concepts taught in entry-level Finance and Economics classes.

SVB LEADING THE BLIND

This is exactly the environment in which Silicon Valley Bank found themselves. In order to try and maximize their portfolio performance, SVB had to purchase Treasures and other instruments with longer term maturities. This was all done leading up to the Federal Reserve's policy reversal, in which the Fed decided to combat inflation by raising rates.

What is very important to understand is that the Fed did not reverse policy overnight or in a surprise move. The Federal Reserve very clearly telegraphed their intentions to slow our economy and reduce inflation by increasing interest rates aggressively. The interest rate hikes by the Fed were based on sound economic data, and Jay Powell made no secret of their intentions.

The portfolio managers at SVB either didn't foresee this move, or they just ignored the risk and left their portfolio full of longer maturity holdings. Therefore, when they needed cash, the holdings were sold at a loss. This spooked depositors, who then reduced their exposure in the bank, which caused the bank to sell more holdings to generate more cash, which further spooked depositors....and the Death Spiral ensued. Bankrupt.

As depositors, we need to be aware of the risks we take when we hold cash in a bank. The FDIC will protect depositors up to $250,000. Any additional assets are at risk in the event of a bank failure. In the case of SVB, the Treasury granted the FDIC an exception so that depositors were protected for their fully deported amounts, even if they were above $250,000. This was a great move by the Treasury as it reinforced confidence in our banking system and stopped what could have been, a huge run on the banking system. That was the exception though, not the rule. Depositors are only protected up to $250,000 under FDIC insurance.

HERE WE GO AGAIN?

Personally, as soon as the SVB new hit, I picked up the phone and called the CEO of a bank with which I do business. We've been friends for many years so after a brief amount of small talk, I asked "By the way, what's the average maturity in your banks portfolio?" Without missing a beat, he confidently responded "Less than 4 years." I told him that there were two reasons that answer was brilliant:

1. It's brilliant that they're managing their bank assets appropriately and conservatively. Both are great qualities in a bank. And...

2. It's brilliant that he actually knew the answer. ...I wonder if the SVB CEO did?

SVB wasn't the only bank to find itself in trouble as a handful of others also ended up in the hands of the FDIC around the same time. It's also interesting to note that bank borrowing at the Fed Window has also been high lately. At these high overnight rates, one can only assume we'll see more consolidation in the banking sector going forward.

To illustrate my point, please see the table below. At the end of the Dot Com bubble burst, there were just over 9,100 FDIC Institutions. By 2013, just 10 years later, we were down to 6,800. Then by December 2022; the number of FDIC institutions had fallen to 4,700 and continues to fall. Big banks have gotten bigger; I.E. J.P. Morgan gobbled up First Republic Bank. Regional Banks have also seen massive consolidation, leaving perhaps a hole for smaller local banks to fill.

We'll see.

FDIC

Statistics At A Glance

As of September 30, 2023

Dollar Amounts in Billions					Asset Concentration Group								
Third Quarter 2023		All Insured Institutions	Commercial Banks	Savings Institutions	Credit Card Lenders	International Banks	Agricultural Banks	Commercial Lenders	Mortgage Lenders	Consumer Lenders	Other Specialized <$1 Billion	All Other <$1 Billion	All Other >$1 Billion
Number of FDIC-Insured		4,614	4,049	565	10	5	1,020	2,523	318	39	233	399	67
Number of FDIC-Supervised		2,952	2,670	282	5	0	727	1,630	153	26	138	249	24
Total Assets	$	23,409	22,200	1,208	490	5,798	295	8,368	613	390	50	92	7,313
Total Loans	$	12,344	11,708	636	409	2,062	194	5,609	212	296	13	52	3,497
Domestic Deposits	$	17,158	16,185	973	374	3,132	248	6,742	497	317	42	80	5,726
Bank Net Income (QTR)	$	68.393	66.230	2.163	3.186	18.640	0.917	20.203	0.812	1.013	0.249	0.253	23.120
Percent Profitable (QTR)	%	93.4	95.2	80.7	90.0	100.0	96.5	94.8	78.6	84.6	86.3	94.0	92.5
Average Return on Assets (QTR)	%	1.17	1.19	0.71	2.64	1.28	1.25	0.97	0.52	1.05	1.97	1.10	1.27
Average Return on Equity (QTR)	%	12.18	12.33	8.83	25.59	13.62	14.16	9.71	7.77	12.47	17.10	12.47	13.16
Net Interest Margin (QTR)	%	3.30	3.30	3.29	10.74	2.91	3.40	3.33	1.55	3.61	3.11	3.48	3.19
Equity to Assets	%	9.58	9.66	8.11	10.25	9.46	8.68	9.91	6.81	8.34	11.04	8.64	9.60
Noncurrent Loan Rate - Total Loans[1]	%	0.82	0.80	1.22	1.50	0.73	0.54	0.71	0.40	0.64	0.77	0.61	1.03
Real Estate Loans	%	1.00	0.98	1.21	0.75	0.98	0.52	0.78	0.43	0.18	0.80	0.56	1.82
C&I Loans	%	0.68	0.68	0.77	0.70	0.76	0.81	0.76	0.46	0.84	0.83	0.73	0.51
Loans to Individuals	%	1.01	0.97	1.43	1.61	0.91	0.35	0.54	0.13	0.81	0.63	0.57	1.08
Coverage Ratio[2]	%	209.94	210.78	199.83	471.03	256.03	244.62	181.66	156.90	322.49	212.26	203.28	172.36
Net Charge-Off Rate - All Loans (QTR)	%	0.51	0.49	0.86	3.57	0.57	0.05	0.22	0.02	0.93	0.34	0.05	0.60
Real Estate Loans (QTR)	%	0.05	0.06	0.00	0.01	0.01	0.01	0.06	-0.01	0.00	0.10	0.00	0.08
C&I Loans (QTR)	%	0.39	0.39	0.46	2.32	0.29	0.18	0.45	0.01	0.29	0.12	0.07	0.25
Loans to Individuals (QTR)	%	2.28	2.21	3.24	3.78	2.36	0.46	1.22	0.34	1.48	2.07	0.35	2.32
Third Quarter 2022													
Number of FDIC-Insured		4,746	4,160	586	11	5	1,064	2,468	306	41	314	460	77
Number of FDIC-Supervised		3,062	2,768	294	5	0	752	1,611	150	24	192	300	28
Total Assets	$	23,631	22,257	1,374	552	5,827	297	7,549	758	577	71	110	7,890
Total Loans	$	12,001	11,305	696	468	1,870	185	5,010	271	437	19	60	3,681
Domestic Deposits	$	17,891	16,717	1,175	406	3,237	258	6,287	678	480	62	97	6,385
Bank Net Income (QTR)	$	71.663	67.909	3.754	4.632	15.354	1.015	23.374	1.925	1.863	0.377	0.308	22.814
Percent Profitable (QTR)	%	96.4	97.2	91.3	90.9	100.0	98.5	97.6	90.2	90.2	87.3	96.1	97.4
Average Return on Assets (QTR)	%	1.21	1.22	1.08	3.43	1.05	1.37	1.24	0.98	1.31	2.14	1.12	1.16
Average Return on Equity (QTR)	%	13.09	13.06	13.57	28.83	11.72	15.94	12.80	15.94	15.64	21.37	12.96	12.45
Net Interest Margin (QTR)	%	3.14	3.13	3.41	11.35	2.46	3.54	3.49	2.13	3.46	2.85	3.47	2.78
Equity to Assets	%	9.15	9.25	7.62	11.55	8.97	8.34	9.51	5.80	8.23	9.48	8.42	9.20
Noncurrent Loan Rate - Total Loans[1]	%	0.72	0.69	1.24	1.16	0.72	0.57	0.66	0.76	0.43	0.61	0.57	0.79
Real Estate Loans	%	0.92	0.87	1.42	0.79	1.15	0.55	0.73	0.81	0.12	0.62	0.58	1.46
C&I Loans	%	0.63	0.63	0.72	0.44	0.88	0.91	0.66	0.53	0.61	0.62	0.76	0.50
Loans to Individuals	%	0.73	0.71	0.97	1.25	0.57	0.33	0.45	0.07	0.81	0.40	0.44	0.63
Coverage Ratio[2]	%	214.87	220.67	162.60	576.98	246.93	239.10	182.11	82.31	333.26	277.10	217.43	170.00
Net Charge-Off Rate - All Loans (QTR)	%	0.26	0.25	0.44	2.13	0.31	0.04	0.10	0.01	0.41	0.08	0.03	0.22
Real Estate Loans (QTR)	%	-0.01	-0.01	-0.01	-0.02	-0.05	0.01	0.00	0.00	0.00	-0.04	-0.01	-0.02
C&I Loans (QTR)	%	0.17	0.16	0.67	1.03	0.14	0.13	0.19	0.02	0.42	-0.05	0.10	0.09
Loans to Individuals (QTR)	%	1.26	1.21	1.95	2.28	1.29	0.39	0.76	0.20	0.92	0.79	0.26	0.99

[1] Nonaccruing loans and loans past due 90+ days.

[2] Loss reserve as a percentage of noncurrent loans.

THINGS TO KNOW: 2024

By Tyson R. Smith

NEW TAX BRACKETS FOR 2024

Tax Rate	For Single Filers	For Married Individuals Filing Joint Returns	For Heads of Households
10%	$0 to $11,600	$0 to $23,200	$0 to $16,550
12%	$11,600 to $47,150	$23,200 to $94,300	$16,550 to $63,100
22%	$47,150 to $100,525	$94,300 to $201,050	$63,100 to $100,500
24%	$100,525 to $191,950	$201,050 to $383,900	$100,500 to $191,950
32%	$191,950 to $243,725	$383,900 to $487,450	$191,950 to $243,700
35%	$243,725 to $609,350	$487,450 to $731,200	$243,700 to $609,350
37%	$609,350 or more	$731,200 or more	$609,350 or more

NEW CONTRIBUTION LIMITS FOR 2024

Retirement Account Type	2024
401(k), 403(b), most 457 plans, and the federal government's Thrift Savings Plan salary deferral limit (401k catch-up contribution is $7,500):	$23,000
Individual Retirement Accounts (IRA) and Roth IRAs contribution limit:	$7,000 ($8,000 for individuals age 50 and older)
SEP IRAs and Solo 401(k)s contribution limit (For those 50 or older, there is also a $7,500 401(k) catch-up contribution amount allowing total contributions for 2024 of $76,500):	$69,000
SIMPLE IRAs salary deferral limit:	$16,000

CURRENT TOPICS

By Tyson R. Smith

WE ARE CONSTANTLY ANSWERING QUESTIONS FROM CLIENTS ON A VARIETY OF DIFFERENT TOPICS. WE AIM TO ANSWER THE ONES WE FEEL ARE THE MOST PRESCIENT IN THESE NEWSLETTERS; HOWEVER, SOMETIMES THAT MEANS WE DO NOT ADDRESS THE OTHER ISSUES WE ARE SEEING.

SO IF YOU, OR ANYONE YOU KNOW, HAS QUESTIONS, THOUGHTS, CONCERNS ABOUT SOME OF THE OTHER TOPICS WE'VE LISTED BELOW PLEASE DON'T HESITATE TO REACH OUT TO US USING THE CONTACT INFORMATION WE'VE LISTED BELOW.

- **MIDDLE EASTERN CONFLICTS**
- **SECURE ACT 2.0 IMPLEMENTATION**
- **BUSINESS SUCCESSION & EXIT PLANNING**
- **EUROZONE SUPPLY CHAIN ISSUES**
- **CRYPTOCURRENCY ETPS**
- **TENSIONS BETWEEN CHINA & TAIWAN**
- **ESTATE ISSUES**
- **DURATION WITHIN YOUR PORTFOLIO**

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MIAMI & A WEDDING

By Tyson R. Smith

There are weddings & then there are weddings.

This one was the latter.

As some of you may know, my partner, Mr. René A. Naranjo recently got married to Dr. Melissa Morello this past December.

The lovely couple was wed at the Church of The Little Flower cathedral in Coral Gables, Fl by Father Manny Alvarez. It was traditional Catholic ceremony and everyone, especially the bride, looked fantastic. If you have never been to the Church of The Little Flower, it is jaw-droppingly gorgeous. I highly encourage anyone visiting South Florida to take a moment and pass by, it's worth the trip.

After the ceremony, we were shuttled to the reception at The Cruz Building in Coconut Grove. For those of you that have had the privilege of getting to know Mr. Naranjo, you will know that he is quite the showman and movie buff. Let me tell you, the couple did not disappoint! I have never been to such an elegant wedding with so much charm, class, and pyrotechnics. Literally, the couple chose Metallica's "Enter Sandman" as their entrance music and walked into the reception with pyrotechnics!

The most astounding part is that the energy of the evening continued to ratchet up as guests were treated to new experiences as they progressively ascended the multi-level building throughout the night; finally, culminating at the indoor/outdoor rooftop level where guests were treated to dancing, Cuban coffee, Italian cannolis, a live rolling cigar bar, and much more.

We could not be happier or more honored to have been part of such a magnificent evening.

Please join us in congratulating the newlyweds and wishing them nothing but the best!

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Our Private Wealth Management group is best described as a Multi-Family Office specializing in:

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