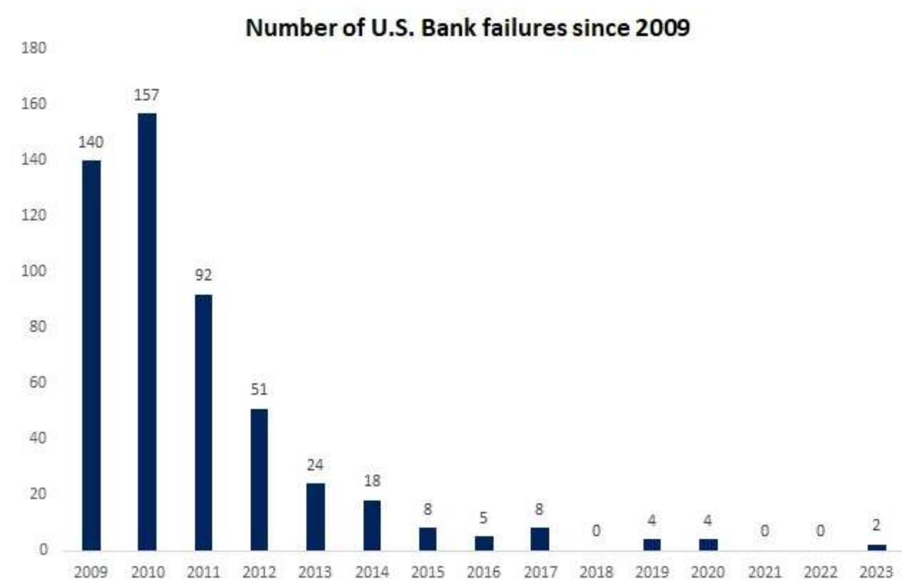
Monday, March 20, 2023

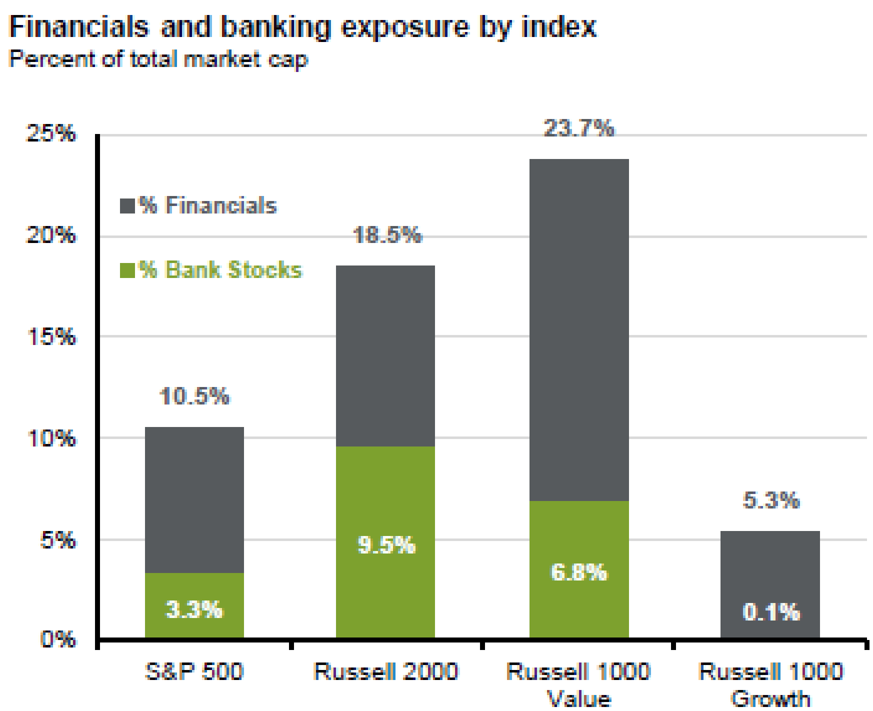
Good morning:

In response to the old Wall Street adage “A rising tide raises all ships,” Warren Buffet once said, “Only when the tide goes out do you discover who’s been swimming naked.” The current issue of *exposure* for a few domestic and one international bank is not the same as it was in the 2008-09 financial crisis when many banks’ balance sheets were full of risky loans and defaulting mortgages. In this month’s turmoil, banks that had diminishing deposits from a highly concentrated depositor base, coupled with unhedged long-term bond portfolios trading at steep discounts found themselves unable to raise new capital spooking customers to quickly pull out their money. The absence of a single bank failure in the U.S. in more than two years prior to last week’s two was enough to send shockwaves throughout the banking sector, particularly the regional banks.



Source: FDIC

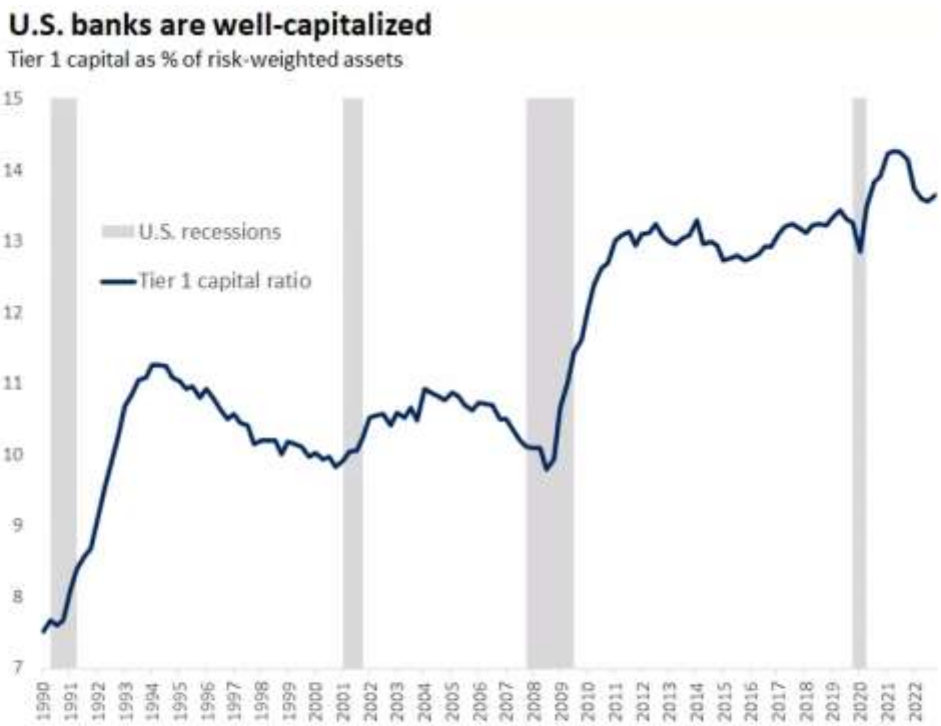
Over the weekend, the Swiss government orchestrated a takeover of their long-troubled problem bank by the nation’s largest bank in an effort to quickly end the fear and anxiety impacting the global banking system. Unlike 2008-09, these banking problems currently do not appear likely to morph into a structural crisis. Last week’s equity market results reflected assets flowing out of smaller regional banks that have a large weighting in the Russell 2000 which lost another -2.57%, and then flowing into technology stocks helping the NASDAQ gain 4.44%.



Source: J.P. Morgan Asset Management

Reacting to this weekend’s developments, banks and financial stocks are all mostly higher to start this week, helping the Dow add more than 300 points in early trading. The other big focus this week will be the FOMC meeting on Wednesday to see if the Fed goes through with their previously anticipated rate hike of another 0.25%. With inflation coming in last week at 6% year-over-year, declining but still far above the Fed's 2% target, we still feel the Fed will hike. However, since the other result of the current banking "mini crisis" is likely to be tighter credit and fewer loans, the result will prove to be disinflationary and have a dampening effect on economic growth – exactly what the Fed is trying to orchestrate. Therefore, we will be watching closely to see if the Fed makes any indication that they may pause sooner than planned to observe the economic impact of current events.

It is important to understand that most banks and financial institutions are currently stable and well-capitalized. This is particularly true of the largest U.S. banks. While it is possible that other banks will suffer the same fate or be subject to merger or acquisition out of necessity, the overall strength and capitalization levels of the broader U.S. banking system should enable most institutions to successfully navigate through these troubled times.



Source: FDIC

Lessons learned during the 2008-09 financial crisis about how to shore up such institutions and restore confidence have essentially created a playbook for central banks and banking regulators. Their quick response to these various situations makes it clear that they are following this playbook which has so far proven effective.

Have a great week!

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Market return and statistical data obtained from: https://am.jpmorgan.com/blob-gim/1383452890099/83456/weekly_market_recap.pdf?segment=AMERICAS_US_ADV&locale=en_US

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