Disclaimer

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- All stocks and options shown are examples only
- Any pricing or potential profitability shown does not take into account your trade size, brokerage commissions or taxes which will affect actual investment returns.
- Stocks and options involve risk and are not suitable for all investors and investing in options carries substantial risk.
- Past stock or option performance is no guarantee of future price appreciation or depreciation.
- Prior to buying or selling options, a person must receive a copy of Characteristics and Risks of Standardized Options available at:http://www.cboe.com/Resources/Intro.aspx.

InvestorsObserver

Workshop

InvestorsObserver Workshop

- Charts
- Hot Right Now
- What Else is Happening?
- Banks, Silicon Valley Bank and You
- Member-driven content: Questions, site demonstrations, etc.
    - Can prepare slides for questions submitted ahead of time: Mention “workshop”

S&P 500

S&P 500
One Year

NASDAQ

Nasdaq
One Year

Russell 2000

Russell 2000
One Year

S&P 500 vs. Equal Weight

One Year, Daily Candles

IO

Growth vs. Value

one year, daily candles

Hot Right Now

- Energy
  - Thermal Coal
  - Oil & Gas Midstream
  - Oil & Gas Refining & Marketing
- Industrials
  - Airports & Air Services
  - Infrastructure Operations
  - Rental & Leasing Services
- Consumer Defensive
  - Beverages - Brewers
  - Confectioners
  - Discount Stores
- Consumer Cyclical
  - Residential Construction
  - Luxury Goods
  - Resorts & Casinos
- Utilities
  - Utilities - Diversified
  - Utilities - Regulated Water
  - Utilities - Regulated Electric

What Else is Going On?

- Economic Data Generally Pretty Good
    - Some softening, but nothing that really looks like a recession
    - Labor market remains almost stubbornly strong
    - CPI keeps going up, PPI down two of last three months (this boosts profit margins)
- Fed Has a More Complicated Task Now
    - Probably 25 bps next week
    - "Long and variable lags" starting to show up in the banking sector
        - Probably means a slower pace of hikes for a while
        - Could mean it takes longer to get to a higher rate
        - May also mean the rate is ultimately lower than it otherwise would have been
            - Dot plot will also come out next week
- Housing Market Slowing
    - Homebuilders are doing great
    - Prices for existing homes have stalled a bit with higher rates
- Debt Ceiling
    - Not close enough to be a concern yet, but will be hearing about it more at we get closer to June
    - First thing to watch is the short-term Treasury Note market (This week's craziness is not related)

How Do Banks Work?

- Borrow short to lend long
- This is the basic business of banking
  - Short-term rates tend to be lower than long-term rates
  - Rates also rise with risk, so deposit rates tend to be lower than rates for riskier things
- There's a lot of services and fee revenue in modern banking, but "borrow short to lend long" is the core business
- This means that rather than having an operating business, the bank's business IS the balance sheet.
  - Try to get a return on assets that is greater than the cost of liabilities + operating costs
  - Liabilities: Deposits, some bonds, other borrowing
  - Assets: Loans, bonds, other lending.
- Most of those assets and liabilities are essentially contracts
  - Someone is lending money to be repaid, with interest on some schedule.
- The major exception is deposits, specifically "demand deposits" (not CDs or other "timed deposits")
  - Demand deposits are callable at any time!
  - This potentially creates some risk, because it's hard to match the duration of assets and liabilities when you don't when you liabilities will be called... This is a bank run.
- One purpose of deposit insurance is to prevent bank runs.

What Happened at SVB?

- Silicon Valley Bank was kind of a strange bank.
    - Specialized in serving Silicon Valley, but also lots of startups and VC-funded companies.
        - Less diversification in terms of liabilities than most banks have
        - Got a LOT of new deposits during the VC boom of the last several years.
    - It also ran a "high-touch" business. "Relationship banking" and bankers cost a lot more than just having some tellers in a lobby and an ATM network.
- The combination of a high-touch business and a flood of deposits caused it to reach for yield.
    - Buying longer-dated instruments which have higher interest rates (but are more sensitive to changes in interest rates).
    - It isn't that the assets themselves were risky, Treasuries and agency MBS are government-backed and will always be money-good if held to maturity.
- The big surprise seemed to be caused by the lack of diversification on the liability side.
    - Silicon Valley, and the VC industry is controlled by a relatively small group of people who all talk to each other
    - The big risk they're trying to avoid is missing something... It's a herd mentality.
    - Went big on crypto and web3, now they're all investing in AI
        - Likewise, no one wanted to be last one out of SVB

What Happened at SVB? cont.

- Assets worth less than they company paid
  - This is on a mark-to-market basis, there is no indication these assets are all all impaired
  - If you see a lot of deposits going out, you end up having to sell, so you have to take the market price
- No Chief Risk Officer for most of 2022
- Management rejected suggestion to shorten duration in 2020 and apparently even as the Fed made clear rates would rise, still didn't make a lot of effort until it was too late
- Company tried to raise capital
  - A bank isn't just twin pools of assets and liabilities, it also has capital. The first loan is made out of shareholder equity, that's also where excess profits and losses go.
- VCs started to flee and a vicious cycle ensues
- FDIC has to step in at that point to protect depositors.
  - It also takes over whatever assets remain, as the FDIC can provide some immediate liquidity and keep the assets to maturity.

The Aftermath

- FDIC said ALL deposits at SVB would be covered
    - This is only sort of news for SVB depositors. Since the FDIC has different funding mechanisms than any individual bank, most depositors are *eventually* made whole.
    - A bunch of VCs were very upset that they didn't have immediate access to all of their funds (this is make pretty ironic because two years ago, many of these same people were leading the crypto charge and proclaiming that the government was the source of all banking and finance problems)
- Covering ALL deposits should help limit deposit flight at other banks with a lot of uninsured deposits.
- New Fed facility to lend against assets at par.
    - This means you can borrow against bonds at the face value, as opposed to the market value.
    - Again, Fed has different funding than a bank, so they can afford to hold assets to maturity
    - Loans are only good for one year
    - Program only runs through March 11, 2024
    - Assets are only eligible if they were on the balance sheet as of March 12, 2023
- SVB's executives all lost their jobs and shares are assumed to be worth $0.00
    - This is different from the 2008 bank bailouts, where stocks didn't go to $0 and executives kept their jobs, or got golden parachutes

Should I Check on My Bank?

- No.
  - If you have less than $250,000 per institution, you're covered by the FDIC
  - There is now an implicit backstop of assets above that (and again, depositors rarely lose money)
  - If you have more than $250,000 and don't need it immediately for working capital, why not put it somewhere that has some return?
- Most banks don't have these problems.
  - Giant banks have different rules (which used to apply to these medium-sized banks and will hopefully come back)
  - Most smaller banks have a more diversified set of depositors, and haven't had such a giant ramp up in assets.
- From a systemic and regulatory perspective depositors shouldn't have to do due diligence.
  - This would lead to even more deposits at Too Big to Fail institutions
  - Bank deposits are supposed to be a risk-free asset, if you introduce any element of risk to deposits, you change the incentives for both bankers and depositors. A dollar in a any bank should have the same value as a dollar outside a bank or at any other bank.

What About Bank Stocks?

- Some of these dynamics will apply to all banks
  - Falling bond prices may hit earnings
  - Deposit rates have lagged rates in other spaces by a lot, that's likely to change
- So expect lower earnings from the more traditional regional banks.
- Regulatory picture is unclear, but any changes would likely also push down earnings

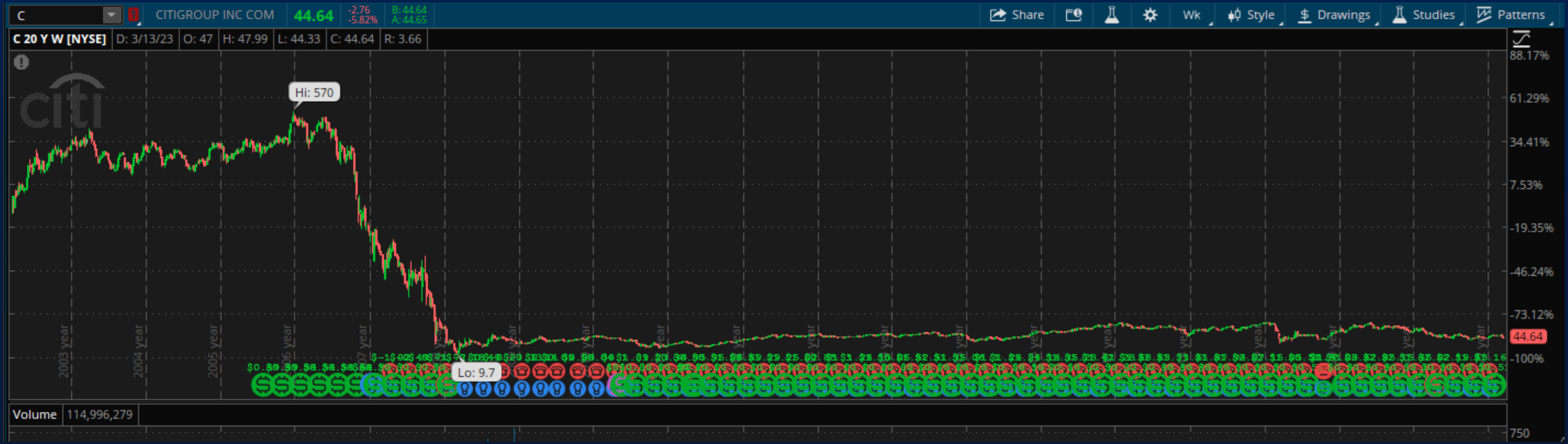
- So sell bank stocks?
  - Not necessarily.
    - A lot of them are fine and have pretty high dividends at current prices
    - Look for banks with a diversified customer base
      - Deposits AND Lending
  - Remember banks are basically a utility. They all provide pretty much the same services
    - "Financial innovation" has a bad reputation for a good reason
      - There haven't been a lot of actual innovations over the last several decades
      - Lots of things that look like innovation are just new names for things that existed already, but someone is trying to price differently.
      - As utility-like institutions, be wary of rapid growth, especially when compared to peers or the industry as a whole.

Some Bank Charts #1

SIVB vs. Regional Bank ETF (KRE) over the last five years.

The peaks are a little different, but the patterns is similar for Silvergate (SI) and Signature (SBNY)

Some Bank Charts #2



Citigroup over the last 20 years.

Shareholders didn't go to $0, but they're still VERY underwater.

Questions?

1) News, comments, analysts, and fund managers in the media are giving bad signals and expectations to investors, is real the risk we are going to face worse times ahead and a crash in the stock market is real in the near future?
2) What is the best strategy for the long term investor right now? What stocks are the best picks to avoid a bloodbath in case of a market crash? –Luca

Not News → → → → Huge News
Plane lands safely and on time → Extreme turbulence → Plane crashes → Plane disappears

This is how TV time is allocated. You've never heard anyone say they expect stocks to return about 8% this year with some volatility along the way… That's a prediction that's relatively likely to be correct, but… that's basically the average year, so it's not an exciting prediction.

This is where asset allocation and market discipline come into play:
If you knew what was going to happen in 2020 at the end of 2019, are you positioning your portfolio for a big rally? Probably not

- Don't put money you can't afford to lose in risky assets.
- Rebalance periodically (this usually means trimming winners and adding to laggards)
- Riskiest stocks are often those that promise the highest return… think unprofitable tech

Questions?