REVIEW AND COMMENTARY
1st QUARTER – 2023

Peaks and Valley(s)

Higher interest rates have finally taken a toll on the financial sector, particularly in the United States. After a run-on Silicon Valley (SVB) and Signature Bank, regulators stepped in and shut down these banks. SVB had been around for 40 years and amassed assets of over $200 billion to make it the 16th largest bank in the United States. Its primary business was lending to Venture Capitalists and startup companies, an important layer in the bedrock of capitalism. Ironically, it was a few of these venture capitalists who rang the alarm bell that created panic. In one day, SVB depositors tried to pull out over $42 billion dollars. It is doubtful any financial institution could survive a one day call on approximately one quarter of their assets.

Certainly, executives at SVB must be held accountable. Despite a well-advertised policy of increasing interest rates, SVB had an inordinate amount of long-term US treasuries that had performed poorly over the past two years. The position of Risk Officer had remained unfilled for more than 6 months up to the early part of 2023. While there may be additional issues uncovered, the immediacy of modern-day communications leaves us all vulnerable to an "act now, ask questions later" mentality. This mindset will continue to reverberate through the financial industry for decades.

Federal Depository Insurance Corporation (FDIC) insures bank deposits up to $250,000. Many SVB clients had significantly higher balances. As the 16th largest bank in the US was unable to meet their depositors' cash demands, losses mounted quickly and the Federal Reserve, US Department of the Treasury and FDIC jointly stepped in to save the bank. All depositors, regardless of whether their deposits exceeded the above amount, would get all their money back. This meant that cash for operations, such as payroll and accounts payable, would be available and there would be no business disruption, which was a welcome relief for not only business owners and their employees but also the capital markets. But there was a price to pay. Equity investors in these companies suffered enormous losses; some debenture holders may as well. The fallout from SVB had repercussions world-wide. Among the most notable, Credit Suisse, founded in 1856, was taken under by its main rival Union Bank of Switzerland (UBS).

……../2

While fingers are being pointed, bank failures in the United States are not uncommon. Under the previous U.S. administration, banking regulations were relaxed. And while interest rates during the Trump administration were much lower than present levels, there were bank failures. In March, USA Today posted an article affirming that over 15 banks failed during the previous administration's leadership. None of these failures were near the size of SVB. And many of these failures were the result of various decisions made over several years if not decades. It is also important to note that there are approximately 4000 banks in the U.S, many of them a fraction of the size of SVB.

Stock prices of our Canadian financial institutions were not immune to the SVB fallout. Many of our banks have increased their presence south of our border, primarily through acquisitions, over the past two decades. The Canadian banking sector posted modest gains over in the first quarter or 2023. As well, broad major equity indexes in Canada and the U.S. posted gains year to date with the SP 500 gaining just over 7% while the SP TSX Total Return index gaining 4.6%. High growth companies, such as technology companies, remain increasingly influential in these broad indices. Last quarter, the performance of Information Technology led all other sectors of the SPTSX index.

While the collapse of SVB and the shock waves sent through the financial markets, an important focus for investors will be on the future direction of interest rates. The fallout surrounding SVB may assist in turning the direction of interest rates. Loan growth in the U.S. banking sector is slowing. Money supply is contracting, in part because of the significant recent equity losses in the banking industry as well as crypto- currencies. While many believe the SVB collapse may lead to a recession in the U.S. we do not believe this is inevitable. Despite hundreds of thousands of layoffs in the U.S. technology industry alone, the world's largest economy is remarkably resilient. Supply chain issues seem to be slowly improving, which in turn could moderate inflationary pressures. Furthermore, if U.S. real estate prices continue to ease, so should inflation. We maintain there remains a decent chance that there will not be a significant recession, if one at all. If so, the equity markets will continue to trend upward.