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A UK focused Turnaround Value Investment Partnership

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# TODAY'S TOPICS

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1. Initial thoughts on Silicon Valley Bank failure
2. Silicon Valley bank & potential other failures
3. Credit crisis ahead?

# 1. INITIAL THOUGHTS ON SILICON VALLEY BANK FAILURE

# POTENTIAL MARKET REACTION – RUN FOR SAFETY?

## ➤ Initial thought:

Fed will not hike interest rates further

Oil and gold and other \$ linked assets will rally as US\$ depreciates

## ➤ Revised thought:

If Fed needs to cut interest rates next week in light of bank runs, this would confirm panic

Yields will need go lower from here to improve held-to-maturity securities valuation

Value of US\$ uncertain, as other central bank would also cut rates and flight to safety would outweigh interest rate differentials

No bailout is a mistake. There is a reason why the Japanese called the Global Financial Crisis of 2008 the Lehman Shock

## 2. SILICON VALLEY BANK & POTENTIAL OTHER FAILURES

# SILICON VALLEY BANK – A MISMATCH OF \$15BN+

- Silicon Valley Bank (\$212bn assets) Dec-22 vs. Dec-21 (equity down -63% last week):
  - Higher risk taking:

Interest rate swaps declined by \$10bn to zero on \$91bn held-to-maturity securities and \$26bn available-for-sale securities
  - Cash needs enforced by offering attractive deposit rates:

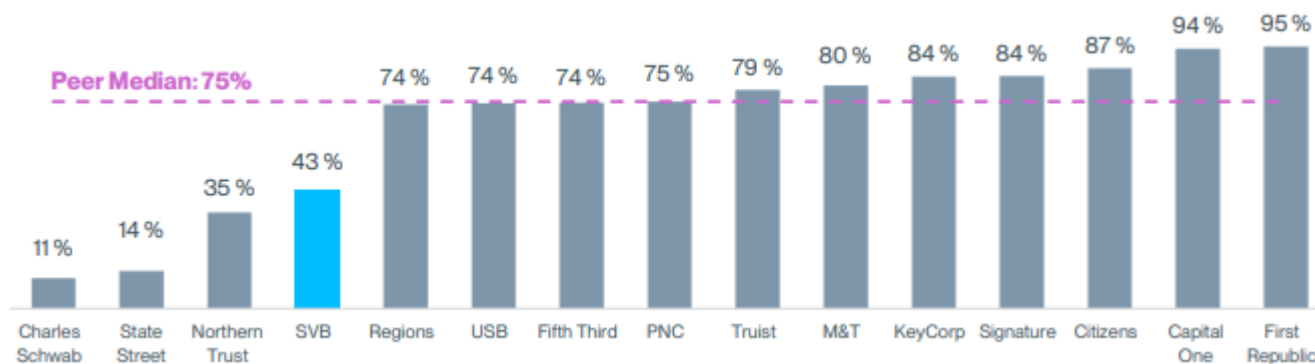
Noninterest-bearing demand deposits fell by \$45bn to \$80bn and interest-bearing deposits grew by \$30bn to \$92bn. Net loans increased by \$8bn to \$74bn while investment securities declined by \$8bn to \$120bn
  - Cash shortage was visible:

Short-term borrowing went up by \$13.5bn from zero, long-term debt doubled to \$5bn

# SILICON VALLEY BANK – HELD-TO-MATURITY PROBLEMS

- Silicon Valley Bank (SVB) is comparing their low loan-to-deposit ratios to their competitors
- While this might have protected SVB from a bank run partially, SVB holds a large proportion of assets as securities held-to-maturity → these are not being re-valued as available-for-sale securities, and if held at longer maturities and not hedged via interest rate swaps cause a risk by hiding actual liquidity

## Loan-to-deposit ratios of US regional banks





# FIRST REPUBLIC BANK – RISK OF BANK RUN

- First Republic Bank (\$213bn assets) Dec-22 vs. Dec-21 (equity down -33% last week):

- Use of Federal Home Loan Bank to grow loans:

Federal Home Loan Bank borrowing grew by \$10bn to \$14bn, while single & multifamily loans increased by \$28bn to \$120bn

- Loan to deposit ratio is high at 95%:

Certificates of deposits and money market savings increased \$23bn to \$47b.

Noninterest-bearing checking accounts declined by \$8bn to \$62.5bn and make up 35% of all deposits

Cash balances declined by \$8bn to \$4.3bn, with \$3.3bn steady debt securities

available-for-sale and a \$6bn increase in debt securities held-to-maturity at \$28.3bn

# CAPITAL ONE – LOWER RISK OF BANK RUN

➤ Capital One (\$455bn assets) Dec-22 vs. Dec-21 (equity down -11% last week):

➤ Balance sheet appears healthy:

No debt securities held-to-maturity, but their debt securities available-for-sale declined by \$18bn to \$76bn. However, this was offset with \$31bn in new loans to \$299bn and \$8bn in interest-bearing deposits to \$25bn (asset)

➤ High loan-to-deposit ratio of 94%:

Despite the high ratio, loans only make up 73% of the balance sheet with cash and securities available for sale leaving a buffer in case of a bank run (First Republic Bank loans make up 83% of their balance sheet and with little cash and securities available-for-sale)

# SIGNATURE BANK – ANOTHER POSSIBLE BANK RUN

➤ Signature Bank (\$110bn assets) Dec-22 vs. Dec-21 (equity down -38% last week):

➤ Declining deposits:

Non-interest-bearing deposits declined by \$13bn to \$31bn and interest-bearing deposits declined by \$4.5bn to \$57bn

While cash declined by \$24bn to \$6bn, loans only increased by \$9bn to \$74bn.

Securities available-for-sale went up by \$1bn to \$18bn and held-to-maturity securities up by \$3bn to \$7bn → Decline in deposits reason for decline in cash

➤ Increase in Federal Home Loan Bank borrowings:

Federal Home Loan Bank borrowings increased by \$9bn to \$11bn

# WESTERN ALLIANCE BANCORPORATION – IN DECLINE

- Western Alliance Bancorporation (\$68bn assets) Dec-22 vs. Dec-21 (equity down -32% last week):

- Higher real estate exposure:

Loans grew by \$12bn to \$51bn mostly through residential and commercial real estate mortgages

- Low liquidity:

Only has around \$9bn in short-term liquid assets.

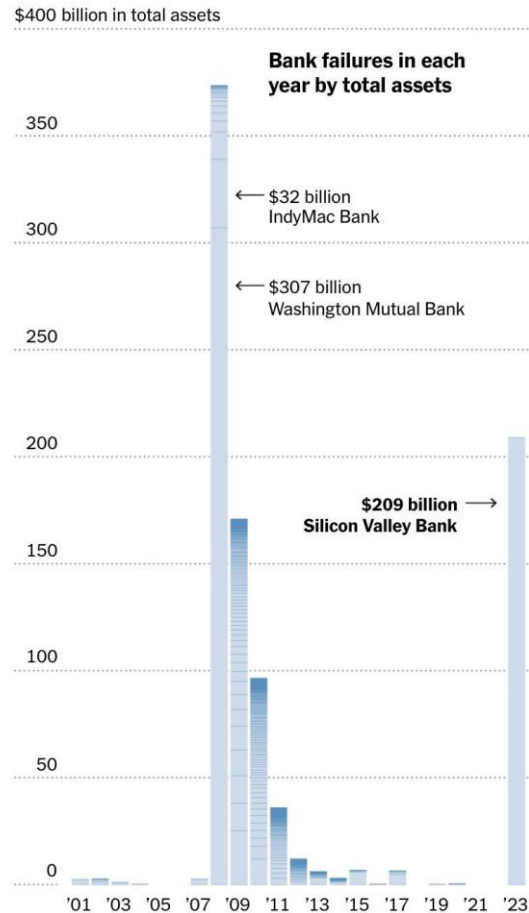
While deposits overall grew by \$6bn to \$53bn, borrowing jumped by over \$5bn to \$6.3bn. Without the additional borrowing, there would be only \$4bn in liquid assets

### 3. CREDIT CRISIS AHEAD?

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# SILICON VALLEY BANK IN PERSPECTIVE – LARGE FAILURE

## ➤ SVB failure in perspective: A large failure

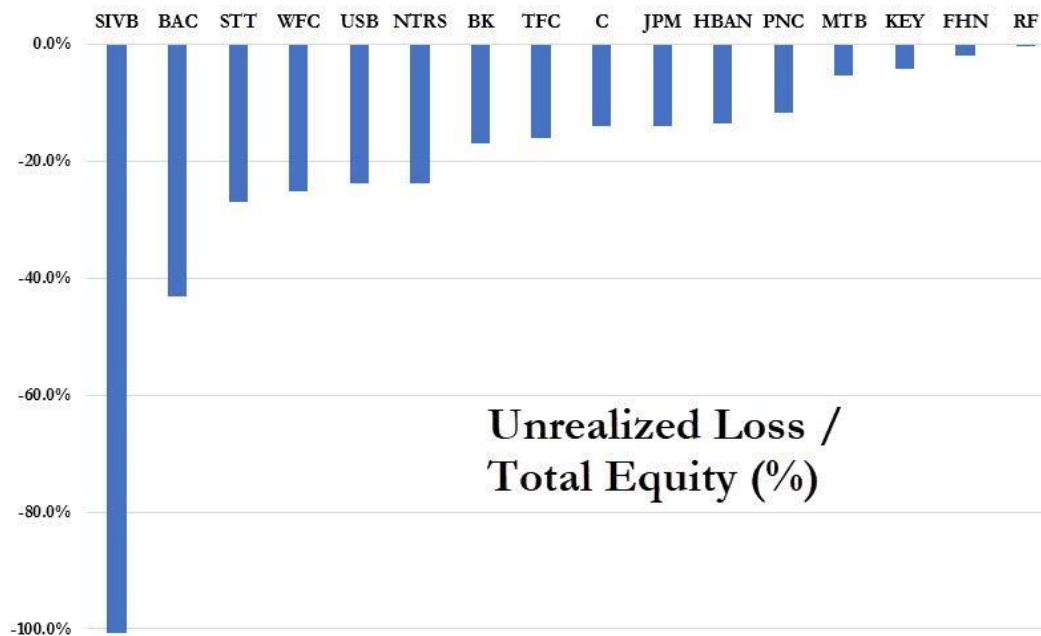


Source: [Federal Deposit Insurance Corporation](#) • Note: Chart includes failures of federally insured U.S. banks and does not include investment banks. • By Karl Russell

# OTHER HELD-TO-MATURITY LOSSES – WORSE TO COME?

- Bank of America in danger? It appears so far only a regional bank crisis....
- BAML has \$600bn in held-to-maturity securities compared to a \$3trn balance sheet.

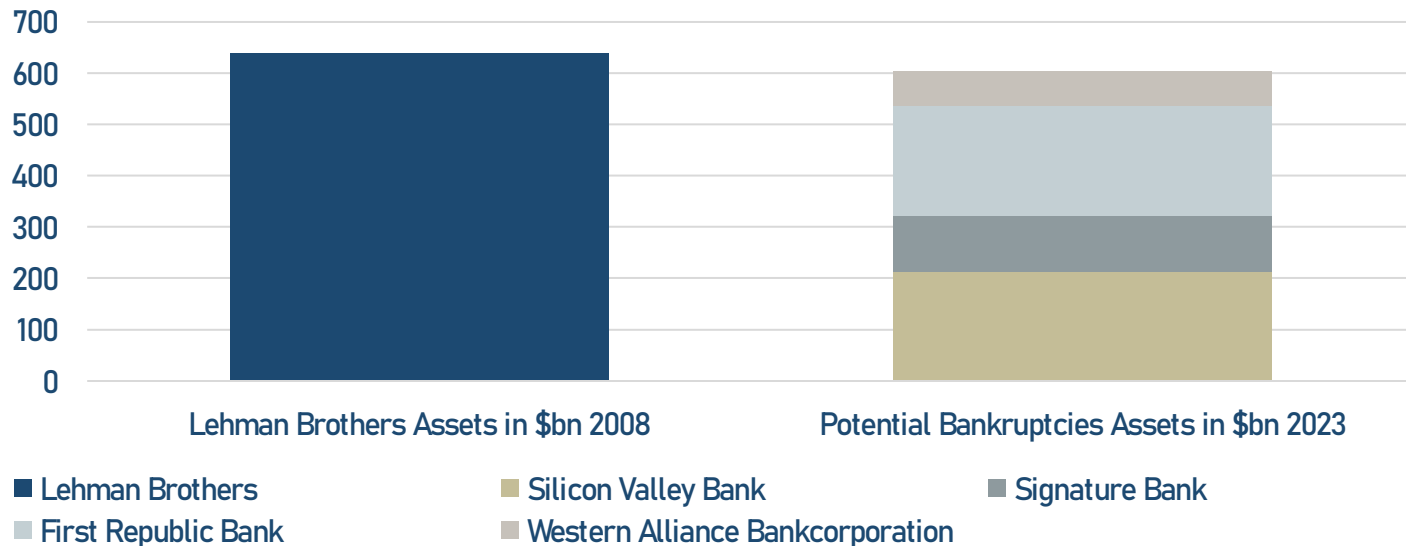
That's 20% compared to SVB's 43%, hence needs to be put in perspective



# POTENTIAL BANKRUPTCIES – IN PERSPECTIVE

- If below 4 regional banks fail, their combined asset size would be equivalent to that of Lehman Brothers in 2008
- Even though deposits might be protected, loans and revolving credit facilities as well as debt could materially slow down economy

Potential current bankruptcies could match that of Lehman Brothers in 2008





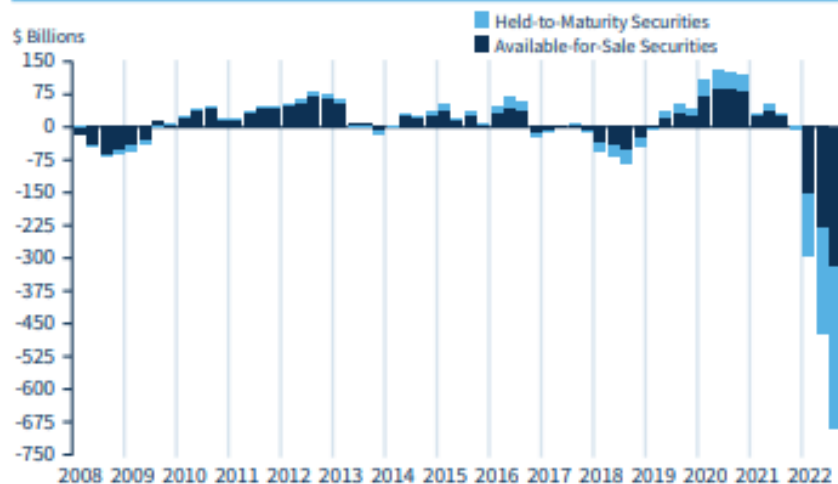
# DEPOSIT INSURANCE – ENOUGH TO COVER 100%?

- FDIC's deposit insurance fund (DIF) has only a sum of \$128bn to cover up to \$250k per depositor in the US
- Silicon Valley Bank has \$173bn in deposits, Signature Bank has \$88bn in deposits
- Sharing it across the banking system could cause more trouble down the road...

Chart 7

## Unrealized Gains (Losses) on Investment Securities

All FDIC-Insured Institutions



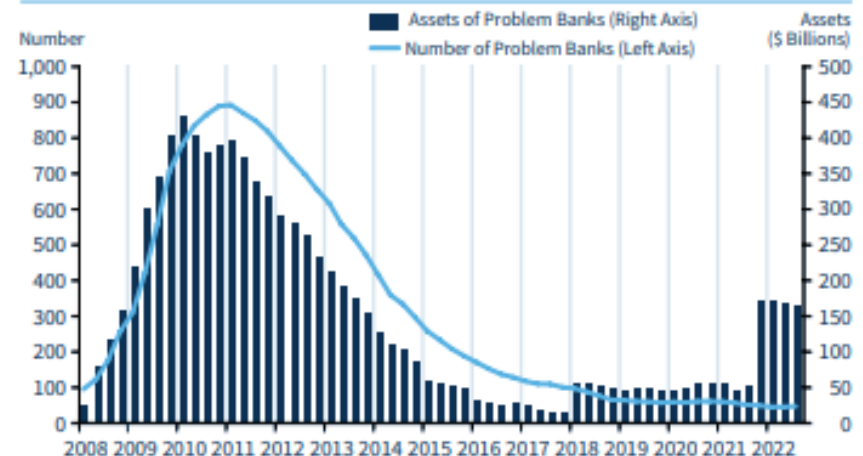
Source: FDIC.

Note: Insured Call Report filers only.

Chart 8

## Number and Assets of Banks on the “Problem Bank List”

All FDIC-Insured Institutions



Source: FDIC.

Note: The asset values of insured financial institutions on the problem bank list are what were on record as of the last day of the quarter.

# IT'S NOT ALL ABOUT DEPOSITS – RCF

- Over 40 UK listed companies updated markets on their connection to SVB and their funding today
- 17 companies have direct exposure either via deposits or revolving credit facilities
- 3 have indirect exposure through portfolio companies
- The 20 other companies have just clarified that they have no exposure or relationship with SVB to calm down investor enquiries
  
- This is panic mode and did not happen during the LDI crisis in September

# IMPORTANT OTHER FACTORS – IT GETS WORSE

## ➤ On the bright side... What about inflation?:

Biden already said on Friday that he is “confident” about the next CPI print. “Live” data suggests a decline in all categories except used-car prices (0.4% m-o-m expectations appear to high)

## ➤ Major policy risks

Biden wants a 25% billionaire tax and large levies on rich investors

Biden’s budget will eliminate oil and gas tax breaks

Biden is poised to further tighten US chipmaking exports to China

High government debt levels and massive government spending programmes (IRA, CHIPS Act, Build Back Better) + higher military confrontation → Is there money for bailouts?