Lessons From March's Bank Run

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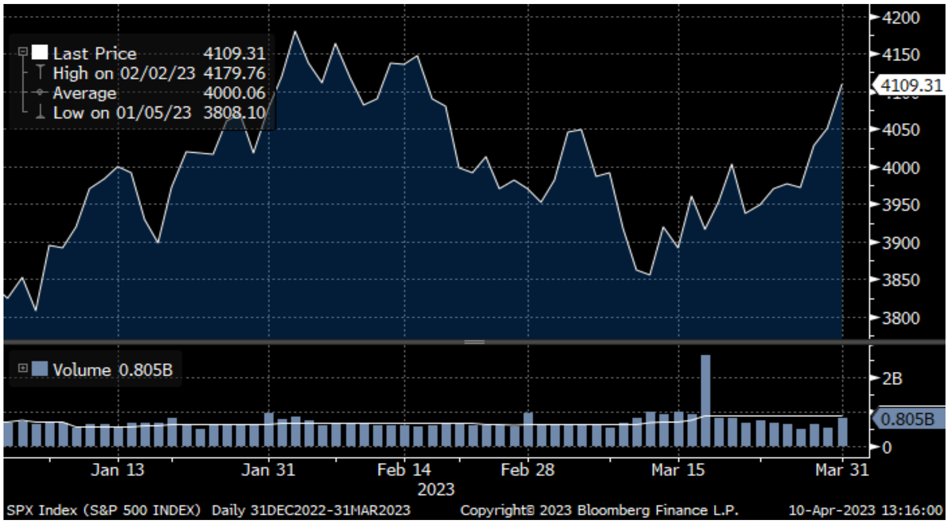
Investors began the year with an extremely optimistic belief that an economic soft landing would be achieved in the U.S. with cooling inflation and that the U.S. Federal Reserve was very close to finished hiking rates. The S&P 500 Index rose to 4180 during the quarter (see chart below). This optimistic expectation was later challenged by continued strength in the labour market that is expected to drive higher input costs and inflation. Markets quickly weakened and fell substantially when bank run news hit the wire in March. It was obvious the Silicon Valley Bank and the Signature Bank would not survive on their own and a few others were also at risk of failing. The Federal Reserve and U.S. Treasury came to the rescue quickly by assuring deposits are safe and by announcing a new program, the Bank Term Funding Program (BTFP), to allow banks to borrow from the Fed using their holdings of government bonds as collateral. The crisis ended quickly, and the equity markets resumed rising on the expectation that the Federal Reserve has to put financial stability ahead of fighting inflation, hence lower terminal interest rates and possibly cuts by end of year.

Year-to-date index performance of the S&P 500 Index:



Source: Bloomberg Finance, L.P.

Stocks are higher, and bonds are also higher broadly on the expectation of lower rates. Shall we just ignore this bank crunch or is there something to be learned? Below are our key takeaways from the current environment:

1. All banks rely heavily on leverage to generate margins and profits. None will have liquidity in short order to satisfy a bank run. As a result, there is a role for central banks to play in an emergency.
2. Deposit insurance has a limit; in Canada it is $100,000. Central banks can print unlimited amounts of money. As long as they are willing, money is not an issue!
3. Government bonds and T-bills are the safest investment as the borrower can print money to pay you, while banks cannot.
4. After the failures of Bear Stearns, Lehman Brothers, and Credit Suisse, investors should understand by now that no single bank is absolutely safe and they should diversify their investments by country, sector, and by names within the sector. It is the old saying, “don’t put all your eggs in one basket.”
5. The current shock will likely have implications:
    a. Banks will be more defensive in lending, hence tightening credit conditions, especially for lower quality borrowers. This also means the risk of recession in the next six to nine months is higher.
    b. Depositors are finding alternatives to deposits, such as T-Bills and money market funds, for higher interest and higher security. This means banks may continue to lose deposits not because of safety concerns, but price.
6. Central banks are influential on the banking system and economies. They have been more active lately as there were more crises than normal in the last two decades. The Fed balance sheet has expanded every time a crisis occurs and only shrinks marginally. It stands at $8.7 trillion today vs. $4 trillion in 2020.

The value of money is questionable, and probably does not get questioned enough. The resurgence of interest in gold bullion and cryptocurrencies suggests there is a growing force voting against central banks. Will they be able to mitigate risks and contain losses, or will further shockwaves hit the broader banking system?

Top 15 Holdings as of March 31st, 2023

1. Canadian Natural Resources Limited	6. Alphabet Inc. Class A	11. Prologic, Inc.
2. Royal Bank of Canada	7. Brookfield Corporation	12. Tencent Holdings Ltd.
3. Toronto-Dominion Bank	8. Alibaba Group Holding Limited	13. Meta Platforms Inc. Class A
4. Suncor Energy Inc.	9. WSP Global Inc.	14. Enbridge Inc.
5. Microsoft Corporation	10. Amazon.com, Inc.	15. Open Text Corporation

Portfolio holdings are subject to change at any time and should not be considered investment advice.

For more information, we encourage you to speak to your advisor or visit us at assante.com