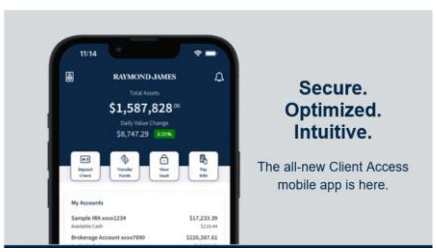
WCM April Newsletter

DID YOU KNOW

Revamped Client Access mobile app



MONTHLY COMMENTARY

Risky Business

Better risk management may be the only truly necessary element of success in banking.

-Alan Greenspan

DOING GOOD TOGETHER

Look to our Newsletters over the next couple of months for opportunities to join us in making a difference.

Thank you for the continued trust you place in us and our office. Our practice continues to grow because of you. Your referrals are the best compliment that you can give.

DID YOU KNOW?

Revamped Client Access mobile app

Having all your key financial information in one place doesn't just make life more manageable, it gives you more time to do what you enjoy.

When we set out to update the Client Access mobile app, we made it our priority to put enhanced usability and personalization at the forefront. That way, you get the level of service and the essential tools to help you achieve your goals.

The all-new mobile app is optimized specifically for iOS or Android devices, featuring intuitive design, personalized insights and an improved user interface.

WHAT'S NEW?

- Improved, more intuitive user interface
- Customizable dashboard
- Streamlined access to your key financial information
- Functionality that improves your relationship with your advisor

Realize the new features and benefits available at your fingertips.

Risky Business

By Mark Lazar

Mark Lazar is an independent writer with Pathway to Prosperity and is not affiliated with Raymond James. Views expressed by this writer are the current opinions of this author and not necessarily those of Raymond James & Associates.

" Better risk management may be the only truly necessary element of success in banking."

- Alan Greenspan

March was a bad month for banks. Two days after the spectacular collapse of Silicon Valley Bank, regulators seized control of Signature Bank, marking the second and third largest bank failures in US history. The following Sunday Treasury Secretary Yellen and Fed chair Powell announced that *all deposits, both insured and uninsured, will be paid in full, including deposits in excess of the FDIC insurance limits, for both institutions*. Adding insult to injury, immediately following the demise of SVB and Signature Bank, First Republic Bank found itself staring into the abyss due to enormous outflows, which prompted the big banks to pony up a $30B lifeline in an effort to dispel fears of a 2008 redux.

Item	YTD Change
S&P 500 Index	7.03%
Dow Jones Ind Avg	.38%
EAFE Foreign Index	7.65%
Emerging Market Index	3.55%
Bloomberg Agg Bond Index	2.98%
10-Year Inflation Forecast	2.30%
Unemployment Rate	3.5%

**Market index data as of 3/31/2023 (The Stock Indexes mentioned are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.)*

A healthy economy requires a stable banking system. The FDIC insures deposits up to stated limits, and the Federal Reserve stands ready as the lender of last resort to provide liquidity in the event of a 1929-style run on the banks. Barring a black swan event, between the two the banking system should be predictable if not boring. As of late, however, the banking system has been neither.

All companies must deal with business (compliance, legal, strategic, operational, and financial) risk, but a fractional reserve banking system amplifies it. To explain, when you deposit a dollar with your bank, they wouldn't have funds to lend. Instead, they use your deposit to make loans to borrowers. Essentially, banks can lend roughly ninety cents of every dollar on deposit, meaning they're highly leveraged, and leverage increases risk.

There have been two major banking crises since the Great Depression; the savings and loan meltdown of the 80s and the Great Financial Crisis of 2008–2009. While the cause of the latter was largely due to failed government policies, the current banking debacle and the S&L collapse share a common cause; a hawkish Fed. When Ronald Reagan took office in 1981 he tasked his (then) Fed chair, Paul Volker, with whipping inflation, which was over 12%. Volker took his task to heart and ultimately raised interest rates to over 22%. Within less than two years inflation fell to 3.8%. However, Volker's medicine was a bitter draught resulting in a not-surprising recession and associated drop in risk asset prices. But the Fed's monetary chemotherapy cleansed inflation from the US economy and set the stage for two decades of high growth and low inflation.

An unintended consequence of the Fed's tight monetary policy was the collapse of savings and loan institutions, which were ubiquitous prior to the mid-80s. While not the only factor, a sharp rise in the federal funds rate both increased the cost of capital and decreased asset values, resulting in the failure of roughly one thousand S&Ls within a few years.

Fast forward to last month. While SVB and Signature were financial intermediaries in the general sense, they operated in a vastly different fashion than traditional banks. SVB catered largely to the tech sector and VC firms. According SVB's website, *We bank nearly half of all US venture-backed startups, and 44% of the US venture-backed technology and healthcare companies that went public in 2022*. By contrast, Signature Bank focused on digital assets by becoming one of a few banks to accept crypto currency, which accounted for roughly one quarter of the bank's deposits.

The common thread between the two was inept management and a failure of board oversight. According to Kevin O'Leary, "The combination of a negligent board of directors at SVB with idiot management is the potent cocktail that led to a disastrous outcome. Why should taxpayers bail them out?" Similarly, it's unthinkable that any bank would allow ~25% of their deposits to be tied to one of the most nebulous and volatile asset classes on the planet. And for the record, Barney Frank, the former ranking member of the House Financial Services Committee, sat on the board of Signature Bank, and was the co-author of the Dodd-Frank banking regulation. The irony.

While depositors and investors alike experienced an overwhelming sense of deja vu last month, and there was no shortage of hand-wringing, it's important to recognize that the current financial problems are vastly different from those of the GFC, when the main issue was credit risk, primarily from sub-prime loans. Today the key issue is interest-rate risk, meaning that when interest rates increase, asset values, including Treasury securities, experience a decline in market value. Apparently, this is a concept SVB's management team failed to understand. Whereas most bank balance sheets tend to hold loans (real estate, consumer, etc.), cash/cash equivalents, and diversified securities, SVB had 55% in bonds, most of which were long term. When interest rates increased, their bond portfolio suffered steep paper losses. But when fear caused a run on the bank, SVB was forced to sell those securities, which turned a paper loss in a realized loss.

Efficient capital markets balance risk and reward. If a saver/investor is unable to withstand market volatility and is willing to settle for low returns, then one should limit savings/investments to FDIC insured deposits, Treasury bills, fixed annuities, and the like. While a stable financial system is paramount, banks should not be immune to failure. No different than a retail or manufacturing company, banks that behave badly/stupidly should suffer the consequences. And the same holds true for depositors. But when government removes the penalties associated with bad behavior it incentivizes moral hazard for bank management, and morale hazard for depositors. SVB's customers were primarily institutions and the ultra-rich, the top ten of which had nearly $4.5B in deposits. Those companies could have used a Treasury management account to ensure their deposits were safe. But apparently thanks to Yellen and Powell, they are; thanks to you.

A competent, effective leader neither panics nor makes impulsive decisions. Events that seem like a crisis at the time rarely are, and this was true of the March's banking hysteria. The proper response would have been to reassure the public that all member banks have insurance, including the smallest local institution, that their money is safe (up to FDIC limits), and to keep calm and carry on; we got this. Instead, the message and *solutions* created fear, confusion, and threatened the stability of small and mid-size banks around the country as deposits were swiftly moved to SIFI, too-big-to-fail banks. The end result will be reduced competition, less available, more costly credit for borrowers, and the big banks will become even bigger and pose an even greater systemic risk.

Absent risk there is no reward. Government cannot nor should it attempt to mitigate all risk from the banking system. Europe is on a dangerous path to potentially nationalizing private banks. There has never been a time in history when this ended well, but instead served to increase the scope and power of government. Unlimited federal insurance may sound appealing, but it's a Faustian Bargain at best.

Mark Lazar, MBA
Certified Financial Planner™
Pathway to Prosperity

WCM Team This Month

Stan

Stan golfing with his mom in Hawaii

Nicola

Nicola with granddaughter.

Rees

Easter Sunday for Petersen Family

Jon

Jon waiting at the Las Vegas Airport with his daughters. Waiting for their grandmother to arrive. It will be her first visit since COVID started

Matt

John

John and Shawn enjoying the snow on the mountain.

Jessica

Jessica and her kids enjoying some snowy mountain air.

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