A Note From Your Advisors

BAIRD

THE MAIN, GOWIN, FISCHER, RICE GROUP

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Clearly the biggest new issue in our economy which has impacted markets recently is the sudden and scary vulnerability of three banks. *Investors are asking questions.* Although each person should have an individual conversation with their own financial advisor (and/or bank), here are some thoughts:

Is this the beginning of a broad collapse in the banking system like we had in 2008?
Of course, if the information available changes we reserve the right to reevaluate our opinion. But given how things currently stand, and the evolution over the past two weeks, we see no evidence that this scare represents anything like what we experienced 15 years ago. Rather this seems like a small number of isolated examples of banks which employed poor (in a couple cases shockingly bad) risk management systems and paid the price for this bad management. For example, Silicon Valley Bank (SVB)'s deposit base was overly concentrated among the technology and life sciences startup world. As a result, many of their corporate depositors had funds on deposit far in excess of the FDIC insurance limit – and these excess deposits were not swept into any kind of Treasury management program etc as would typically be the case at most banks. In addition, a much larger-than-standard percentage of SVB's assets were in the form of long-duration mortgage and Treasury bonds (more than double the percentage of the average bank). As the Fed raised interest rates to fight inflation, the value of these bonds declined sharply. Startup companies began to withdraw large sums from their deposit accounts, which forced SVB to sell these bonds at big losses. Earlier in March it reached a breaking point: their losses realized exceeded working capital. And so SVB became the 2nd biggest bank failure in US history. Most banks in the US do not have such concentration risks or poorly managed bond portfolios. So, we don't see evidence that what befell SVB will likely claim several additional victims.

Did the government bail out these banks? Why?
The word bailout is an inflammatory one and gets peoples' attention quickly. That's why media outlets use it so liberally! In reality, the Federal Reserve and the FDIC stepped in to make it clear that all depositors accounts – even in excess of the FDIC limits – would be accessible to depositors even while this crisis is being addressed. This became the policy to prevent the bank's problems from also being "contagious" to the startup and tech sectors. However, it's important to know that the bank's investors and owners were NOT bailed out by the government. And indeed, when it was announced on 3/27/23 that First Citizens Bank is going to acquire all the deposits and loans of SVB – and will operate SVB's 17 branches – that deal was negotiated and facilitated by the US Government. As compensation the FDIC will receive equity appreciation rights tied to First Citizens' stock price. In other words, if First Citizens benefits from this longer term the FDIC and the taxpayer will benefit financially. There are certainly other elements of this that come into play, and we will remain watchful about the government's role in the financial services sector.

Do I need to be worried about my money market balances at Baird?
Baird's FDIC insured money market sweep program automatically spreads deposited funds over as many as five participating banks. This means that each individual client is insured by the FDIC up to a total of $1.25 million (5 times the FDIC's $250k limit for any individual bank). None of those participating banks are currently caught up in the trouble described above, and Baird continues to monitor closely with strong due diligence programs to reassure our clients that we can feel secure.

What changes should we make to our portfolio because of this?
We remain convinced that volatility will continue in 2023 and have advised our clients to adjust portfolios to be conservative and play defense. It's possible the turmoil may eventually influence the Fed to ease up on further interest rate hikes. If that becomes the case in the future, we are prepared to seek opportunity. If you want to discuss your individual portfolio, we welcome a call any time!

- The Main, Gowin, Fischer, Rice Group

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