May 4, 2023

Raymond F. Saleeby, Jr
President

Saleeby & Associates, Inc.

Where Trust And Confidence Are Paramount ™

Banking Crisis

The stock market experienced a banking crisis approximately seven weeks ago. It is not the first time this has happened, nor will it be the last. Within a few days, the sixteenth largest bank in the nation evaporated. It was the worst financial failure in the past 15 years, and I believe the speed of the collapse was unprecedented. In fact, more than $40 billion was pulled out in 24 hours. I believe the speed was accelerated due to two reasons: 1) how fast negative messaging can spread on social media and 2) the ability to instantly transfer money and assets in our digital economy. In the old days, one had to stand in line at a bank to access personal funds therefore it could take two to three days to collapse which is what happened to the SVB bank.

Government officials, the FDIC, the Treasury Secretary, the Federal Reserve, the President… had a difficult decision whether to insure uninsured deposits or not. If uninsured depositors were not backed, I believe the stock market would have corrected 10%-15% shortly afterwards. However, the repercussions could have been more devastating with uninsured depositors fleeing for safety. I believe there is estimated to be about $10 trillion dollars of deposits that are insured and $8 trillion uninsured in the banking industry nationwide. If they were not backed this could have resulted in a mass panic for insured and uninsured depositors forcing them to transfer their money to the six largest banks in the United States. Many investors and consumers believe these six banks are too large to fail. While we still see some shifting of assets to bigger banks, it would be much greater if the government chose not to insure uninsured depositors. Many businesses have larger deposit balances than the Fed insurance limit because it is cumbersome to fund payroll from multiple banks.

"Silicon Valley Bank was a 40-year-old financial institution based in Santa Clara, California. It was established by former Bank of America staffers to "provid[e] diversified financial services to companies in the technology, life science and premium wine industries." The federally chartered California bank held on to cash deposits from businesses and startup founders primarily concentrated within the tech industry; popular apps like Roku and Lemonade and Etsy and Vox Media had either a little or a lot of money in SVB. By the end of 2022, it was the 16th-largest bank in the U.S., with $209 billion in assets."[1] "Uninsured depositors, which accounted for almost 90% of its deposits (some estimates as high as 97%, began to flee the bank."[2] "One of the biggest beneficiaries of the venture boom was Silicon Valley Bank, a company whose roots go back to 1983. SVB was synonymous with venture capital. If a company was venture-backed, there was a 1 in 2 chance that SVB was their bank. So, from the end of 2019 to the first quarter in 2022, deposits tripled to nearly $200 billion."[3]

Banking Crisis (Continued)

This bank failed for many reasons: poor management, inadequate balance between short and long-term assets, excessive growth, poor regulatory oversight, large unrecognized losses from rising interest rates, and a concentrated asset base in technology investments and depositors. “You shouldn’t have borrowed short and lent long... Finance 101,” Milken said on CNBC’s “Last Call.” “How many times, how many decades are we going to learn this lesson of borrowing overnight and lending long? Whether it was the 1970s, the 1980s and 90s.”[4] Many depositors saw higher yields in other financial institutions thereby moving their money out. Lastly in 2018 the Dodd-Frank Act eased requirements on smaller lenders.

“The famed investor and Berkshire Hathaway CEO told CNBC on Wednesday that several banks engaged in misleading accounting to artificially inflate their profits. He gave the example of banks valuing their long-dated bonds at their par value instead of their market value, which hid the fact their value had fallen on paper.”[5] “At the end of last year U.S. banks were facing more than $600 billion of unrealized losses because of rising rates, federal regulators estimated.”[6] ”This was a huge problem at SVB, where more than 90 percent of the deposits exceeded the amounts covered under federal insurance. The Federal Deposit Insurance Corporation insures deposits for individual accounts up to $250,000, and many other banks also have elevated levels.”[6] ” Midsize banks like SVB do not have the same regulatory oversight as the nation’s biggest banks, who, among other provisions, are subject to tougher requirements to have a certain amount of reserves in moments of crisis.”[6] “At SVB, $151 billion out of $173 billion in total deposits was uninsured.”[7]

A possible solution to this crisis is having more bank consolidation so regulators would be better equipped to monitor fewer banks. I believe there will be fewer smaller and regional banks going forward anyway. Secondly, I believe the government should have a clawback provision where high-level bankers, bank executives, board members, and other management would have to give back options, salaries, bonuses, etc. that they received over the last couple of years. I do not know the perfect timeframe but if there was a clawback, I believe bank boards and management would behave a lot differently if they are hit financially. One must remember that bank officials to some extent are stewards of government capital. In the past, I believe when a failure occurred many bank officials lost their jobs and had very little outside repercussions. Another solution would be to have stricter regulations, stress, liquidity tests and capital requirements, particularly for small and regional banks. In addition, if the bank crisis gets worse the government will have to insure the $8 trillion of uninsured depositors. There lies the moral hazard.

The small and regional banks serve a great purpose. They are life blood for small businesses, institutions, entrepreneurs, and consumers who need access to capital. “Small- and mid-sized banks account for 50% of commercial and industrial lending and 60% of residential real estate lending, among other loans…”[8] Generally, the six big banks want big customers and are less interested in small accounts that are far less profitable and do not move the needle.

A healthy banking system is the life blood to the economy. The banking industry is built on trust between so many different parties, depositors, lenders, government… Another important feature to keep in mind is that the banking industry operates with some sort of dependence on each individual company. There is always a systematic and contagion risk within the industry and the bank itself. In times of trouble the federal government seems to be the last financial back stop if needed.

Banking Crisis (Continued)

One can look back at the 2008 crisis when the housing market collapsed. The government played a great role in causing the banking system not to completely collapse. Since then, there have been new rules and regulations, better capital requirements and hopefully bankers have a recent recollection of the catastrophe. One hopes that history will not repeat itself again like 2008. It is my estimation that the current banking crisis is completely different than 2008. There are many changes like the new regulations, decreased leverage, where we do not have a giant declining industry like the housing industry to trigger it and many other features that distinguish this from the current crisis. Not to mention the increase in capital and strength of larger banks in general.

Even though the banking crisis is fresh on investor's minds, I believe high inflation is a bigger concern. I believe this crisis will cause most banks to tighten their credit standards. In July 2021, I was quoted in The Wall Street Transcript saying "I just think that we're going to have incredible amounts of growth coming up. But I think we're going to have incredible amounts of inflation coming up as well. And quite frankly, corporations are going to be affected by their profit margin. And then if you include taxes, higher taxes, which looks like it's a probability — that could affect earnings. Inflation is like a tax on everybody. And the biggest effect on inflation is going to be from the Federal Reserve. If they're behind the eight ball, then investors are going to start getting concerned even more."[9] I still believe this today that inflation will be elevated in the U.S. and throughout the world due to structural changes for years to come. In time, technology, in particular AI is likely to change employment thereby reducing wage pressures. However, the changes will likely increase the wealth and class disparity in the U.S. thereby increasing political and economic hostility.

Stock Market

The stock market has rallied off the October 2022 lows confounding many investors. One may ask how this could happen with skyrocketing interest rates over the last year and a half. The sixteenth largest bank in the country evaporates in short order with a slowing economy, heighten global tension, a major war in Ukraine… This is why I believe it is so important not to pay attention to market forecasters. In 2001, I was featured in a St. Louis Post Dispatch article where I was asked about a famed financial analyst's market 'prediction'. My response was that the analyst would have roughly the same accuracy as an ape in the zoo. I believe there are many positive and negative factors that investors must weigh to look at their short- and long-term outlook. Not what the stock market is going to do in the short term. It is my opinion that very few people make money trading stocks with short-term thinking. I believe it is easier to predict the future than to predict the timing of the future.

Stock Market (Continued)

On the positive side, I believe investors should consider these factors:

- High employment.
- Some think Artificial Intelligence (AI)/ChatGPT may be a bigger ramification than the internet. It may disrupt and displace labor throughout the world and accelerate class divisions but decrease inflation and increase productivity. Sundar Pichai, the CEO of Google, says that AI is more profound than electricity but warns it comes with serious job implications.
- Tech innovation and revolution particularly with data and 5G internet.
- Infrastructure/Chips/IRA/Government incentive programs.
- Better earnings and forecast from companies in the last couple of weeks for the first quarter.
- Plenty of stimulus funds from Covid still in our financial system. There is estimates of 4-5 trillion in money market funds.
- Tech leadership: Apple, Microsoft…
- China is recovering from Covid lockdown.
- Investors feel the Federal Reserve is winding down their interest rate increases.
- Travel and leisure spending are at heightened levels. Consumers have shifted from goods to experiences.
- "The 4th Industrial Revolution and energy transition are driving immense demand for massive amounts of new types of infrastructure."[10]

On the negative side, I believe investors should consider these factors:

- Ukraine war.
- High inflation and interest rates.
- Banking crisis. Three good-sized banks have failed in the last two months: SVB Bank, Signature Bank, and First Republic (taken over by JP Morgan under government authorization). Many banks will extend and pretend with loans.
- Global tension with China and Russia.
- Office buildings, shopping centers, and some commercial real estate sectors are in bad financial condition.
- More nationalism worldwide.
- Supply channels are changing from China.
- The economy appears to be slowing down. In fact, the Fed predicts a year-end recession.
- Bonds are more competitive than stocks for the first time in fifteen years.
- Many consumers are trading down on purchases.

As one can see that are a lot of positive and negative issues investors must consider. As always it is best to be patient and adjust for the long term. If one needs money within two years, I believe it is best not to risk it. In addition, if one does not have the risk tolerance from the fluctuations that occur in the stock market, they should adjust their portfolio accordingly. However, I believe for most investors a well-diversified portfolio with good companies will do well over time.

Greenification is Upon Us

President Biden passed three different stimulus packages aiming at technology and alternative energies. I believe the Inflation Reduction Act (IRA) has a name that does not resemble its purpose. However, along with that act was the CHIPS Act and various policies that will provide incentives for electric vehicles, semiconductors, rare mineral mining and alternative energy and services. These are all part of the government's ambition to help our climate and reduce dependance on foreign oil and resources.

Thus far our government's ambitions are noble in nature and naive in execution. "At least $137 billion has been invested in new EV factories across the US over the past five years. But not all of it has been enough to meet the stringent requirements for cars to be eligible for tax credits under the Inflation Reduction Act, which aims to boost EV adoption and bring this new manufacturing home."[11] "Now, the industry's deep dependence on China in its supply chain — including at least 70% of EV battery production — and just how hard it is to break those ties, is coming to light."[11] ""The epicenter of where minerals reside, where processing resides, where EV production resides, all are outside of the US," Douglas Kent, EVP of corporate and strategic alliances at the Association for Supply Chain Management, said."[11]

One of the main reasons for buying an electric car is because it is supposed to help the environment. To influence consumers to purchase an electric car our government has created tremendous tax credits. However, "only ten electric vehicles qualify for full $7,500 US tax credit."[12] "Tax credit will shrink or disappear for purchasers of most EVs"[12] "Eight EVs, two plug-in hybrids are in line for $7,500 perk"[12] It is hard to get the full tax credit due to battery source and requirements, income levels… "Before the Inflation Reduction Act, about 92% of EV models on the market were eligible for the $7,500 tax credit, according to the Alliance for Automotive Innovation, an auto-industry lobbying group. That figure dropped to 43% in February."[13]

This act has also alienated many foreign countries that feel America is protecting itself and not being fair competitively. On a positive note, Tesla is dropping its EV prices to gain market share. It might be a similar strategy that was used by Henry Ford in 1913. However, the consumer should be a beneficiary of this.

I believe there are other factors to consider when buying an electric car:

- "...be wary of rosy proclamations about savings. EVs may take five to six years to break even compared with gasoline models, factoring in higher upfront prices and expenses like electricity, insurance, maintenance, and depreciation. There's wide variability in potential savings per model. Some EVs may take 10 years to prove less expensive, while others are a better deal from day one. Much of the long-term savings may depend on whether an EV qualifies for state or federal tax credits."[14]
- "The place to start the number-crunching is with the transaction price. The average price of an EV is about $60,000, generally at least $10,000 more than a comparable gas model. Most EVs are in the premium or luxury segments, driving up the averages, with Tesla commanding more than half the market."[14]

Greenification is Upon Us (Continued)

- "Assuming an EV price premium, you'll then have to factor in the cost of gas versus charging. According to the Natural Resources Defense Council, the cost of charging an EV at home is equivalent to filling up a gas model at roughly $1 per gallon. The current national average is $3.45 per gallon."[14] "Another factor is the cost of a high-speed home charging station. The popular JuiceBox 40 runs about $650, and the ChargePoint Home Flex, about $750. Installation costs vary from about $1,000 to $6,000 depending on how close the charger is to the home's electrical panel, and whether you need a new panel and electrical upgrade, according to Cars.com."[14]

Recently I read an article published by Bloomberg that was very interesting. If you are in the market to buy an electric car, I would highly recommend you read this article as there are some loopholes. https://www.bloomberg.com/news/articles/2023-04-27/ev-tax-credit-loophole-means-leasing-can-save-you-7-500?sref=Ro2vIlyD

So, if you are in the market to buy an electric car it might be better to lease it and get full credit. In any case, just like you do your homework when you invest you should do the same when you buy a car.

As the U.S. moves toward alternative fuels hydrogen will play a greater role. "Efforts to boost production of hydrogen, a fuel seen as crucial for meeting global climate goals, are racing ahead at a rapid pace, particularly in the U.S., threatening Europe's lead, according to a report."[15] "Planned hydrogen electrolyzer projects globally have jumped by 18% in the last six months, surpassing one terawatt of electricity capacity for the first time, according to a semi annual report by Aurora Energy Research."[15] "The European Union has been an early adopter of new low-carbon technologies such as hydrogen electrolyzers, electric vehicles and solar power. However, it has been slow to respond to the Biden administration's Inflation Reduction Act, which earmarked $369 billion for green energy programs. The U.S. now offers straightforward, generous tax credits to clean hydrogen producers while the EU took many months to work out the details of its incentives which generally involve more red tape."[15]

One must understand that there are many limitations with hydrogen including price, flammability, and shortage of electrolyzers. "One of the impediments to huge green hydrogen projects is the short supply of electrolyzers, the machines that use electricity to split water molecules apart, isolating the hydrogen."[16] "Hydrogen is also very flammable, making storage difficult."[16] One must understand that these fuels are the future. Just as there is no perfect stock, there is no perfect path or solution to get these fuels in widespread use any time soon. These government programs are coming at a time when we may need government spending to help offset the weakness in the general economy which I believe is currently slowing down. However, these problems may be more inflationary than the government realizes particularly on the labor side. There lies the ironic part of the name. We need to understand if we have the workforce, infrastructure, and resources to go full speed ahead but only time will tell.

Conclusion

In conclusion, the Federal Reserve has raised rates for the past year and a half and has just raised it again. There are a few cracks in our economic system i.e., small regional banks, office buildings and shopping centers in commercial real estate, technology layoffs… One can assume we are not headed back to an easy money, low interest rate and low inflation environment any time soon. The economy seems to be adjusting to a new order and investors are doing the same. In the last couple of years investors have had low interest rates and were paid to take risks. As Warren Buffett says, you do not know who is swimming naked until the tide goes out. Well, the tide has turned, and we must adjust accordingly. I am confident that Saleeby & Associates has the right infrastructure, experience, and intellectual capital to guide you not only now but in years to come. Our best years lie ahead. Thank you for your trust and confidence.

Optimistically Yours,

Raymond F. Saleeby
President

Footnotes

1. Pahwa, Nitish. (2023 March 13). “How the weekend-long freakout over Silicon Valley Bank ended”. Slate.com. Retrieved from https://slate.com/technology/2023/03/silicon-valley-bank-failure-deposits-fdic-federal-reserve-bailout.html 1 May 2023
2. Sherry, Charles. (16 March 2023). “Bank failures and the stability of the financial system”. Horsesmouth. Retrieved by https://www.horsesmouth.com/bank-failures-and-the-stability-of-the-financial-system 1 May 2023
3. Batnick, Michael. (14 March 2023). “Whose fault is it anyway”. The Irrelevant Investor. Retrieved from https://theirrelevantinvestor.com/2023/03/14/whose-fault-is-it-anyway/ 1 May 2023
4. Li, Yun. (2 May 2023). “Michael Milken says recent crisis is the same mistake banks have been making for decades”. CNBC. Retrieved from https://www.cnbc.com/2023/05/02/michael-milken-says-recent-crisis-is-the-same-mistake-banks-have-been-making-for-decades.html 3 May 2023
5. Mohamed, Theron. (12 April 2023). “Warren Buffett slams banks for hiding their losses – and reveals he sold some bank stocks after spotting reg flags”. Retrieved from https://markets.businessinsider.com/news/stocks/warren-buffett-bank-stocks-accounting-banking-crisis-failures-svb-fdic-2023-4 1 May 2023
6. Zhang, Christine, David Enrich, Karl Russell and Ella Koeze. (18 March 2023). “Why people are worried about banks”. The New York Times. Retrieved from https://www.nytimes.com/interactive/2023/03/18/business/why-people-are-worried-about-banks.html 1 May 2023
7. Fonda, Daren. (17 March 2023). “Why regulators didn’t spot the risks at banks – and how to stop the next failure”. Barron’s Advisor. Retrieved from https://www.barrons.com/articles/banking-regulation-silicon-valley-first-republic-ebcfc98b 1 May 2023
8. Mozee, Carla. (20 March 2023). “Elon Musk sees ‘serious risk’ of another Great Depression if the Fed doesn’t stem the collapse of regional banks after SVB failure”. Market Business Insider. Retrieved from https://markets.businessinsider.com/news/stocks/elon-musk-svb-warning-risk-bank-crisis-first-republic-economy-2023-3 1 May 2023
9. (1 July 2001). “Fragrance and Flavor businesses remain strong in inflationary times”. The Wall Street Transcript. Retrieved from https://www.twst.com/interview/fragrance-and-flavor-businesses-remain-strong-in-inflationary-times?in=bdde3 2 May 2023
10. High Yield Investor. (23 Jan 2023). “We are buying infrastructure hand over fist”. Seeking Alpha. Retrieved from https://seekingalpha.com/article/4571460-we-are-buying-infrastructure-hand-over-fist 1 May 2023
11. St. John, Alexa. (12 April 2023). “The EV revolution has never felt father away”. Business Insider. Retrieved from https://www.businessinsider.com/electric-vehicle-revolution-hits-delays-production-sales-tesla-china-2023-4#:~:text=EVs%20are%20hitting%20the%20American,its%20EV%20transition%2C%20experts%20say. 1 May 2023
12. Natter, Ari and Keith Laing. (17 April 2023). “Only 10 electric vehicles qualify for full $7,500 US tax credit”. Bloomberg. Retrieved from https://www.bloomberg.com/news/articles/2023-04-17/gm-tesla-and-ford-evs-will-be-the-only-cars-eligible-for-7-500-us-tax-credit?sref=Ro2vIlyD 1 May 2023
13. McLain, Sean and Andrew Duehren. (17 April 2023). “To get the EV tax credit, you will now have to buy an American brand”. The Wall Street Journal. Retrieved from https://www.wsj.com/articles/want-a-tax-break-on-an-ev-youll-have-to-buy-an-american-brand-edd8883a 1 May 2023
14. Hube, Karen. (10 March 2023). “Buying an EV? Here’s how long until it will pay off”. Barron’s Advisor. Retrieved from https://www.barrons.com/articles/buying-ev-gas-car-cost-payoff-9516b6d 1 May 2023
15. Horner, Will. (28 April 2023). “North American clean hydrogen projects are booming”. The Wall Street Journal. Retrieved from https://www.wsj.com/articles/north-american-clean-hydrogen-projects-are-booming-75a3d4ed 1 May 2023
16. Bearak, Max. (11 March 2023). “Inside the global race to turn water into fuel”. The New York Times. Retrieved from https://www.nytimes.com/2023/03/11/climate/green-hydrogen-energy.html#:~:text=Inside%20One%20of%20the%20World's,Projects%20%2D%20The%20New%20York%20Times&text=The%20Christmas%20Creek%20iron%20ore,currently%20relies%20on%20fossil%20fuels 1 May 2023

Did You Know

I worked closely with Bill Gates for 8 years as an executive at Microsoft. Here are the 3 lessons he taught me that I'll never forget.
https://news.yahoo.com/worked-closely-bill-gates-8-090000376.html#:~:text=Chris%20Williams%20is%20a%20former,bull%22%20and%20not%20being%20truthful.

Six Types of Wealth
https://www.youngmoney.co/p/six-types-wealth

People living in New York, San Francisco, and Honolulu need to earn $300,000 to feel like they're making $100,000 as inflation bites, survey says
https://www.businessinsider.com/300000-salary-feels-like-100000-us-cities-new-york-honolulu-2023-4

Homeowners insurance covers your home, personal property, personal liability, and additional living expenses
https://www.businessinsider.com/personal-finance/what-does-homeowners-insurance-cover

Take a look inside the largest house in the US – a Vanderbilt's 130-year-old private mansion with 35 bedrooms, 43 bathrooms, and 65 fireplaces
https://www.businessinsider.com/largest-home-in-united-states-biltmore-estate-photos

Saudi Arabia's Neom is a $500B futuristic city being built in the desert – but it could morph into a surveillance dystopia
https://www.businessinsider.com/neom-what-we-know-saudi-arabia-500bn-mega-city-2019-9

Yogi Berra's baseball greatness and exemplary life recognized in new documentary
https://www.forbes.com/sites/christianred/2023/04/19/yogi-berras-baseball-greatness-and-exemplary-life-recognized-in-new-documentary/

The 25 richest American families, ranked
https://www.businessinsider.com/richest-billionaire-families-america-2018-7

AI disruption deepens with Chegg Plunge, IBM hiring halt, Samsung Chatbot ban
https://www.bloomberg.com/news/articles/2023-05-02/ai-s-long-reach-chegg-s-plunge-ibm-hiring-pause-samsung-ban?sref=Ro2vIlyD

Scientists say they made a mind-reading AI that can turn scans into a readout of your thoughts
https://www.businessinsider.com/mind-reading-ai-recreated-story-brain-scan-2023-5#:~:text=Scientists%20say%20they%20trained%20AI,story%20accurately%2C%20per%20a%20study

Warren Buffett eats McDonald's for breakfast, drinks 5 Cokes a day, and devours cookies and ice cream. Here are the investor's 11 best quotes about his iconic diet.
https://www.businessinsider.in/stock-market/news/warren-buffett-eats-mcdonalds-for-breakfast-drinks-5-cokes-a-day-and-devours-cookies-and-ice-cream-here-are-the-investors-11-best-quotes-about-his-iconic-diet-/articleshow/99870461.cms

Did You Know (Continued)

Elon Musk's private jet emitted 132 times as much carbon as the average American does in an entire year
https://www.businessinsider.com/elon-musk-private-jet-carbon-footprint-climate-change-2023-4

Sam's Club is testing out a robot that can grill and assemble your burger. And you can order and pay for it without even speaking to a human
https://africa.businessinsider.com/retail/sams-club-is-testing-out-a-robot-that-can-grill-and-assemble-your-burger-and-you-can/p354m2c

***Disclaimer**: Saleeby & Associates does not provide tax advice. Please consult with your tax advisor with regard to your personal situation. By clicking on these links, you will be redirected to a third party server. We have not independently verified the information available through these links. The link is provided to you as a matter of interest.*

Saleeby & Associates, Inc.

Achieving your goals is our passion

11301 Olive Blvd.
Creve Coeur, MO 63141

Phone: 314-997-7486
Fax: 314-997-1417
E-mail: rsaleeby@cutterco.com

Check us out at saleebyandassociates.com