

What Does the Silicon Valley Bank Collapse Mean for Investors?

Presented by D&B Strategic Wealth

Americans have suddenly witnessed three very large bank failures in only a few days' time. The first was the collapse last week of Silvergate, also known as "the Crypto bank." Soon after, we read the news of both Silicon Valley Bank (SVB) and Signature Bank collapsing. These are some of the largest bank failures in U.S. history. What is going on here? Should we be worried? Is another financial crisis on the horizon? The short answer is no.

Why We Shouldn't Press the Panic Button

Let's start with the bottom line before we get into the details. This is something to keep an eye on, but it's not the start of the next financial crisis. Unlike in the great financial crisis of 2008, the government is getting ahead of the problem rather than trying to clean up afterward. That is a very positive sign. We can certainly expect market turbulence—in fact, we're seeing it already—but the systemic effects will be limited, and we're not set for another major crisis.

Instead, the takeaway so far is that regulators and the federal government are on the case and are willing and able to support the financial system. Sunday night, the U.S. Treasury announced that depositors would be fully protected in the interest of maintaining systemic confidence and that funds were being made available to support banks under stress. Again, this quick action is what differentiates this situation from that of 2008.

What Will Happen Now?

Many people have written good descriptions of how and why these banks collapsed, and I won't try to replicate those. To investors, the "why" is interesting, but what we really need to know is what it all means for the future.

Firstly, the Federal Reserve's (Fed's) interest rate hikes are indeed affecting the financial system. While the effects on the SVB assets were more intense, other banks are wrestling with the same problems. Expect to see banks, and the entire financial sector, pull back on lending and risk until they get their houses in order. This will slow economic growth and likely pull markets down. In some respects, this is good—it's the effect the Fed has been targeting. **It makes a recession much more likely, however, and it could quite possibly happen sooner than later.**

Secondly, the fact that the collapses have principally been in the tech and crypto spaces suggests that these sectors are even more at risk than the economy as a whole. While other banks will likely move to replace SVB, they will not be as focused or as dedicated to the sector, and **things will slow down in the tech sector going forward.** In short, one of the primary enablers of the tech boom is now gone.

These are both reasonable outcomes, and ones we have not only seen before but were expecting.

Do These Failures Indicate a System-Wide Problem?

The answer to this question is good news. To set the stage, let's look at the three factors that caused the financial system to lock up in 2008:

- There was little transparency around asset values, which caused a lack of liquidity for those assets.
- Banks didn't have sufficient capital to weather a crisis.
- There wasn't enough available credit in the early stages of the crisis to support the banks until liquidity came back.

We're in a very different place now on all three.

In terms of the liquidity issue, U.S. banks generally now hold very liquid assets, dominated by U.S. Treasury notes. Those values are clear, and there is a large market for them. Banks can raise cash, if necessary, simply by selling or borrowing against those assets.