What Does the Silicon Valley Bank Collapse Mean for Investors?

Presented by EPA Financial Services

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 are 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.

Regarding sufficient capital, U.S. banks are, by and large, very well capitalized. They have the money to weather storms and, as noted, they can access those funds. These circumstances are both very different from those of 2008.

The third cause, lack of available credit, is where we must be careful. Banks have seen those Treasury notes decline in value significantly as rates rose, and there are questions in some cases about whether the value of the bank capital still covers the liabilities. This is what drove the collapse of SVB. What the Treasury did Sunday, however, was to solve this problem by providing a way for banks to borrow against long-term assets, like Treasuries, based on the par value, not the current market value. That largely eliminates the insolvency problem and will provide the credit that was missing in 2008. It will not eliminate the entire problem, though, as banks may still need to rebuild their capital bases. But it will allow the banks time to recover, which will be key to rebalancing the system.

Explained differently, the system is more transparent and has a more solid foundation compared to 2008. The government has also identified the remaining problems and put programs in place to deal with them. From a depositor's perspective, the government's decision to stand behind all deposits also reduces the risk of further bank runs. With a stronger system in place, and the government being aggressively proactive, there looks to be little systemic risk right now. We won't see another great financial crisis.

What Comes Next?

What we *can* expect to see is continued turbulence. Even though the system will hold, investors still need to figure out the effects of what has happened. It will be a bumpy ride, but one that will eventually end. This story is not over yet, and we don't fully know how it will play out. We do know, however, that we will make it through.

Heather Barone

EPA Financial Services

2040 US Highway 9 │ Toms River, NJ 08755

732.286.1000 │ 732.286.1005 fax │ www.epafinancial.com │ heather@epafinancial.com