TANDEM WEALTH MANAGEMENT

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Recent Bank Failures

Being a long-term investor takes patience. Despite the recent economic turmoil and bank failures, remaining focused on your long-term plan is still the best plan of action. Ultimately, the Federal Reserve's interest rate increases were intended to create stressors on the economy. The hope was to thread the needle to create enough stressors to reduce the money supply without causing a recession. Yet, if you ever attempted sewing, some will invariably feel the needle's pain. And we are at that point. Poorly positioned banks such as Silicon Valley Bank (SVB) and Signature Bank were more vulnerable.

The U.S. Government stepped in to guarantee the deposits to avoid contagion or a domino effect since the failure of Silicon Valley Bank is the second largest in history, followed by the third largest of Signature Bank. The U.S. Government decided to insure all depositors of SVB and Signature regardless of Federal Deposit Insurance Corporation (FDIC) limits in these circumstances. In addition, a new program called Bank Term Funding Program (BTFP) will assist banks with liquidity needs by making additional funds available against high-quality securities eliminating the need to realize large losses. However, it is important to note that the government did not bail out these institution's equity holders, unsecured debt holders, or managers.

Thankfully, the diversification in your portfolio acted as a protection against any direct exposure. If there was indirect exposure through a mutual or ETF fund, it was minimal. Conversely, the lack of diversification made these banks more vulnerable. Silicon Valley Bank had a concentrated client base of venture capitalists and technology start-up clients with a lot of cash in 2020 and 2021. Further, they needed more regular depositors like us. Banks create revenue by using deposits to invest in other assets. There are rules and minimum reserve requirements. In the case of SVB, they invested in long-term treasuries that are known to be without default risk since they are backed by "the full faith and credit of the United States," but they are still vulnerable to interest rate hikes.

For many years, bond managers have kept bond durations or maturities low to reduce interest rate risk; yet, last year, fixed income had its worst year in decades, and the worst losses were in long-term bonds. The longer the bond you own, the greater the risk unless you can hold the bond until maturity, when you receive your principal back. As rates increase, the value of the bond decreases since you can purchase a new bond with a higher interest rate. When large customers of SVB requested their cash, the bank had to sell their long-term Treasuries for a realized loss since they could no longer hold them to maturity and meet their reserve requirements.

Typically, banks will hedge against interest rate hikes, yet, SVB did not. It also did not have a risk officer for a significant amount of time. As for Signature Bank, being a leader in the cryptocurrency market and having a large focus on this type of currency made it vulnerable, especially after the turbulent year for crypto in 2021. When Signature Bank attempted to diversify, many depositors began moving money. Reserve requirements an become a problem if a large number of depositors request their money all at once. Regulators look for vulnerabilities, but in this case, they were not caught until it was too late.

While banks failing is a relatable concern since we all keep money in a bank, I believe the deposits are safe, and the broader banking system remains healthy. You can verify that your bank accounts are covered by FDIC using the Electronic Deposit Insurance Estimator (EDIE):

FDIC: Electronic Deposit Insurance Estimator (EDIE)

Despite the recent failures, the Federal Reserve continues to raise interest rates at a more subdued pace since inflation remains an issue despite slowly improving.

Finally, remember you are not alone in weathering the uncertainty. I am here.

Kind regards,
Meghan

Meghan Phillips Dykstra CFP®
Investment Advisor Representative
900 East Front Street, Suite 200
Traverse City, MI 49686
phone: 231-486-6188
fax: 231-486-6191
Meghan.dykstra@SecuritiesAmerica.com
TandemWealthTC.com