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MARKET UPDATE

Over the last three days, two significant banks closed. Silicon Valley Bank (SVB) closed on Friday, and Signature Bank (SB) over the weekend. Clients have concerns which we hope are addressed below:

Are my assets at Charles Schwab safe?

Your assets at Charles Schwab are safe.

- Yes, your assets at Charles Schwab are safe.
- Your assets are segregated, meaning they are separate from Schwab's assets, and are therefore fully protected (even in the very unlikely event of bankruptcy).
- Cash at Schwab is FDIC insured like a regular bank.
- Schwab accounts are covered by SIPC (insurance like FDIC), and Schwab has additional insurance from Lloyds of London.
- The Schwab money market funds we use only own US Treasuries or other US government obligations.
    - As of 12/31/2022, the funds we use only owned US Treasuries.
- Margin accounts are fully protected unless they are in a debit balance.

Is the financial system at risk like in 2008?

We do not believe the financial system is anywhere near the risky position it was in 2008.

- We do not believe the financial system is anywhere near the risky position it was in 2008.
    - Large banks have significantly more capital than 2008, meaning they can absorb much more in losses before running into trouble.
- Bank loans are generally higher quality today than 2008.
    - Today over 90% of mortgages are set at lower risk fixed rates.
    - In 2006, 30% of mortgages were riskier, adjustable-rate loans.

What is going on & why is this happening now?

- Generally speaking, higher interest rates have caused losses on bank balance sheets.
    - Banks make fixed interest rate loans / investments to businesses, people (mortgages), and governments (US Treasuries, municipal bonds).
    - The value of these loans / investments falls when interest rates rise. Longer term bonds, including mortgages, fell 10-20% in value last year.
    - This caused the assets at the bank to fall in value.
    - Banks that "hedged" their loans were able to offset some of the decline in asset value.
    - Banks that issued long term debt or raised new equity are more secure.
    - If banks were not hedged and needed to raise money to meet withdrawal requests from depositors, they could have been forced to sell loans / investments at a loss, threatening their solvency.
- Banks like Silicon Valley Bank and Signature Bank did not have enough in hedges or long-term debt to offset declines in asset values.
- In addition, SVB and SB deposit bases were 90%+ corporate clients (according to JP Morgan), which are more vulnerable to "a run on the bank" if concerns arise.

- SVB had concentrated uninsured deposits and loans from / to private equity companies, smaller technology companies, and their employees, all of which have been under stress and burning through cash (and SVB's deposits).
    - SVB sold loans to raise money, but that was the "red flag" which caused deposits to flee for safer banks, and SVB could not raise enough equity to stay solvent.
- SB had a large exposure to cryptocurrencies (15%+ of deposits), which had also done poorly as crypto deposits shrank.

What is being done to prevent runs on other banks?

Government actions should give depositors confidence that they do not need to flee from their current bank.

- Sunday's joint press release from the Federal Reserve, Treasury Department, and FDIC stated all depositors at SVB and SB will be made whole, including those not covered by FDIC.
    - This should calm fears about deposits over the FDIC insured limit in the event of insolvency.
    - This should give depositors confidence that they do not need to flee from their current bank.
- The Federal Reserve has made liquidity available to help all banks meet the needs of their depositors.
    - Instead of selling loans / investments, banks can lend them to the Federal Reserve and receive cash to meet withdrawal requests.

What does this mean for the economy and stocks?

- Historically, many US banks have failed with little impact on the US economy or stock markets.
- SVB and SB had unusual sources of deposits, which most other banks do not have.
    - Banks which have not hedged properly could see significant declines in value.
    - The red flag of asset sales may be avoided, but banks that need to lend their loans to the Federal Reserve may still be signaled out as weak and punished by the markets.
- Higher interest rates and "quantitative tightening" by the Federal Reserve caused stress in some areas of the economy.
    - Interest rates have fallen significantly in recent days, causing the value of loans to rise which helps offset some of the issues plaguing some banks.
- Stocks are down significantly from their 2021 highs, implying some of the potential damage from rate hikes and quantitative tightening is already priced into markets.
- Large banking or country failures, such as Continental Illinois (1984), Orange County (1994), and Russia (1998), have often marked the end of Federal Reserve tightening cycles and ended up being good times to buy stocks.

In the short run, volatility will likely spike and there will be more questions than answers. High quality bonds provide a layer of safety and stronger businesses will be able to take advantage of any dislocations which may occur.

Please feel free to reach out to us at any time.

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DISCLOSURE