What and Who is Silicon Valley Bank and How it Affects You

Good afternoon!

we thought it would be a good idea to address what has transpired down in the states and what is currently all over the news.

For most of us, the words "bank failure" immediately trigger the same recent memory: the financial crisis of 2008. That was a year no investor could ever forget. The year some of the largest, most storied financial institutions in the world — think Lehman Brothers, Bear Stearns, and others — collapsed, never to return.

Similarly, for anyone who has studied history, the words "run on the bank" immediately trigger images of the early days of the Great Depression. For others, it's perhaps scenes from It's a Wonderful Life. (Or Mary Poppins, if you prefer.) Dramatic moments now consigned to the waste bin of time. Surely not something that could happen in this day and age.

But on Friday, March 10, all these words — bank failure, bank run – happened to the Silicon Valley Bank in northern California. It's an event that has many investors, scarred by the memory of 2008, wondering if the same thing could happen to other banks. An event that has only added to the fearful mood currently pervading the markets.

As you probably know, when the news broke on Friday morning, all three major indices immediately tumbled, capping off a rough week for the markets. So, we want to briefly explain what's going on with this semi-obscure bank and why it spooked investors. Then, we want to go over what we can learn from it.

Prior to collapsing, Silicon Valley Bank was the 16th largest in states, holding approximately $209 billion in assets.[1] If you've never heard of it before, it's probably because the bank specialized in lending money to start-up companies; the kind of fledgling tech firms Silicon Valley breeds each year. Now, it has the dubious distinction of being the largest bank to fail since 2008.[1]

So how did a bank this large fail so suddenly? Truth be told, it's a tale that anyone who lived through 2008 also remembers well: The bank simply made too many bad decisions at precisely the wrong time. During the pandemic, tech companies saw a surge in business. This led to a host of new, hopeful tech companies popping up, each flush with venture capital. As a result, banks that specialize in serving these types of companies enjoyed their own surge: A surge in deposits.

Silicon Valley Bank (SVB) was one of these banks. But while business was booming, this was also when the problems started. You see, like most banks, SVB only keeps a fraction of its deposits inhouse at any given time. The rest is lent out or invested. In this case, SVB purchased tens of billions of dollars in U.S. Treasury bonds.

To be fair, there was a certain logic here. Treasury bonds are historically seen as one of the safest investments in the world. Given the market uncertainty we saw during the pandemic, the bank probably thought it was being prudent with customers' money. Unfortunately, the bank forgot one important detail: While Treasurys don't usually see the kind of volatility that stocks or other securities do, they are vulnerable to a very specific kind of risk. The risk of rising interest rates.

While this was going on, the world economies started changing. Inflation skyrocketed. Interest rates, in turn, rose to the highest levels in decades. That meant all those Treasurys purchased when interest rates were low were suddenly far less valuable. (Newer government bonds pay far more in interest than those purchased before the rate hikes began.) At the same time, those tech companies that profited during the pandemic saw business – and their stock prices – fall. For SVB, that meant fewer and fewer deposits coming in. Suddenly, SVB was faced with a nightmare scenario: A lack of liquidity and a lack of new funds.

None of that might have mattered so long as customers didn't start withdrawing their money. Of course, that's exactly what happened. Faced with their own economic distress, all those tech companies – and their executives – started asking for their money back. Given that they only kept a fraction of that money in reserve, SVB had no choice but to sell its investments at a major discount. The result was a major loss of nearly $2 billion, which the bank revealed earlier in the week.[1]

When news of the situation got out, customers began panicking. This led to a classic, seldom-seenbut- much-feared scenario: A run on the bank.

In the days that followed, the bank was unable to stop the bleeding. So, on Friday, the government stepped in and took control of the bank's remaining $175 billion in customer deposits.[2]

Okay. That's the story. But why the impact on the markets?

Aside from being eerily similar to 2008 – a bank makes risky financial decisions at the exact wrong time and crumbles – the situation has investors wondering if there are other banks out there that might soon experience the same problem. No surprise, then, that shares of banks with similar business models have fallen sharply over the last two days.

But it's more than that. Right now, investors are gripped with fears of a recession. On the surface, that may seem counterintuitive, as most areas of the economy remain in decent health. But until the economy cools down, inflation will continue to run hot…which means the Federal Reserve will continue to raise interest rates. (Indeed, the Fed chairman announced on March 8 that he expects rates to rise "higher than previously anticipated.")[3]

With each rate hike, the threat of a recession grows larger.

Right now, investors are hyper-sensitive to anything that looks like the first sign of a recession. And the failure of a major bank certainly qualifies. Hence the turmoil we've seen in the markets this week. Hence the volatility we may keep seeing.

So, what can we learn from this? To our minds, there are a few lessons:

1. When making investing decisions, always prioritize your long-term goals. In the wake of the pandemic, SVB made too many short-term decisions that locked up its long-term options. We will never do that. Here at the Patel Wealth Management Group, our approach will always be to take the slower-but-surer path to your financial goals. We will always emulate the tortoise, not the hare.

2. Never forget the importance of liquidity. We are not a bank. We are human beings, and human beings must contend with the unexpected. That means we sometimes need quick access to our money. That's why we will always invest, save, and plan accordingly.

3. Always hold true to our data-driven, rules-based strategy. Right now, too many investors are overreacting to every headline and news story. They are making decisions based on emotion, expectation, and cognitive bias. We will continue to use technical analysis and the law of supply and demand to determine what is happening right now, and respond accordingly. Whenever market trends dictate that we play defense, we will do so.

We are experiencing a time of uncertainty in the markets. Such times are rarely fun, but they're not unexpected. The good news is that our team continues to have confidence in the road you are taking toward your financial goals. We will continue to monitor the markets very carefully and keep you updated as to what's going on.

In the meantime, please let me know if you have any questions or concerns. We are always here for you.

Have a great month!
Thanks!

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PS: If you ever come across anyone that could benefit from our services, we'd love to help!
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