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Bank crisis in perspective

Trending Conversations

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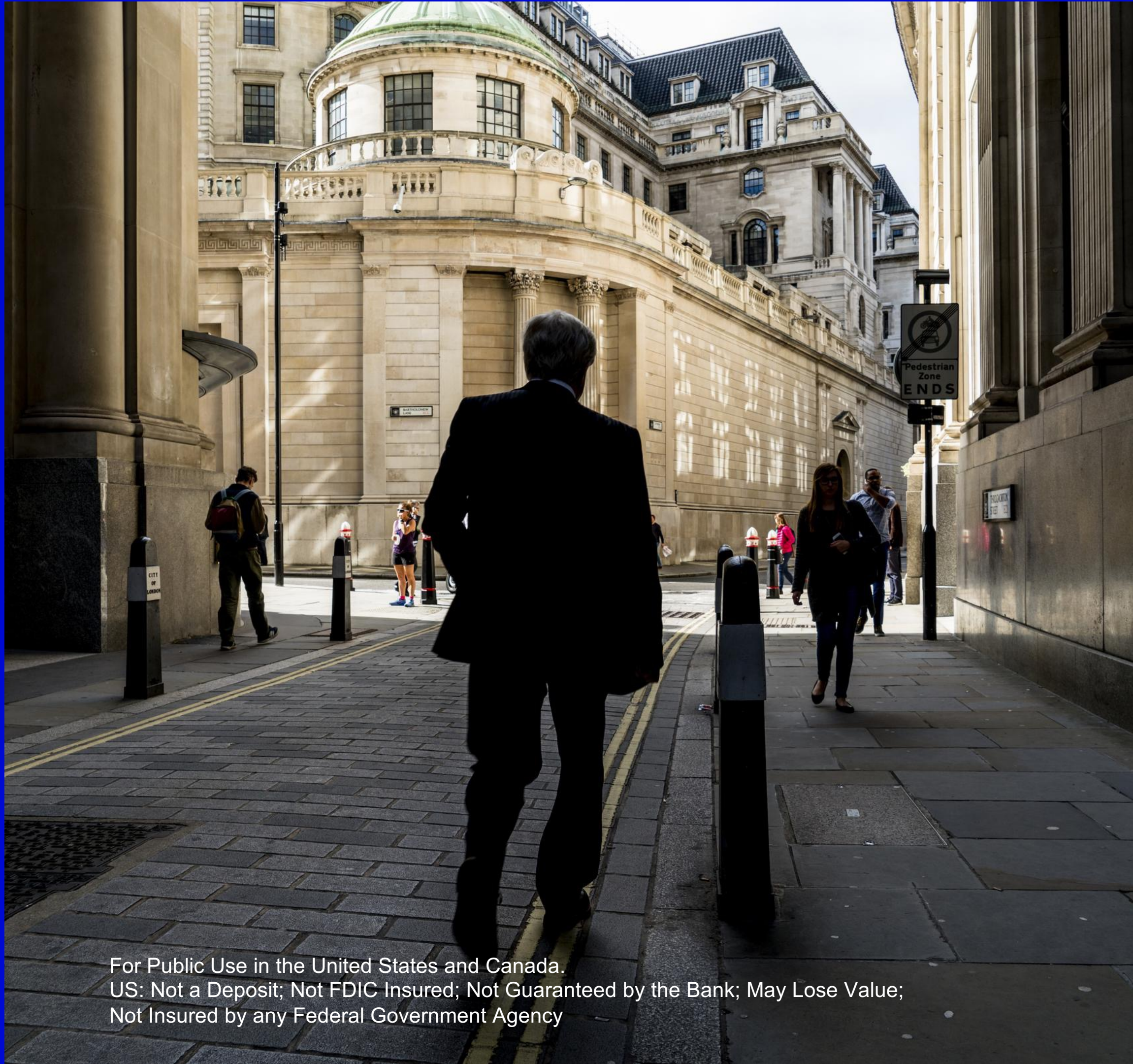


Financial crises are a part of tightening cycles

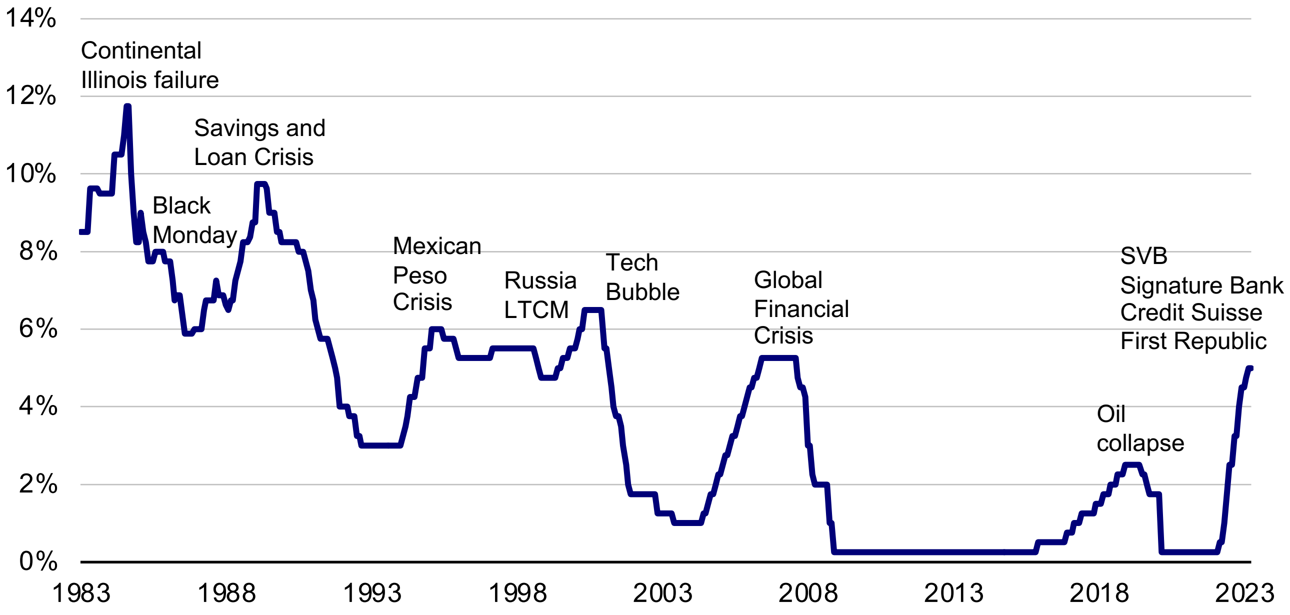
US Federal Reserve (Fed) tightening cycles, without exception, have been associated with financial crises.

Examples:

- Continental Illinois 1984 failure, then the seventh-largest bank by deposits in the US
- Savings and Loan Crisis in late 1980s, when 1,000 other US banks failed

Current tightening cycle appears to be ending similarly, as large financial institutions such as Silicon Valley Bank (SVB), Credit Suisse, and First Republic failed.

Federal funds rate and financial crises



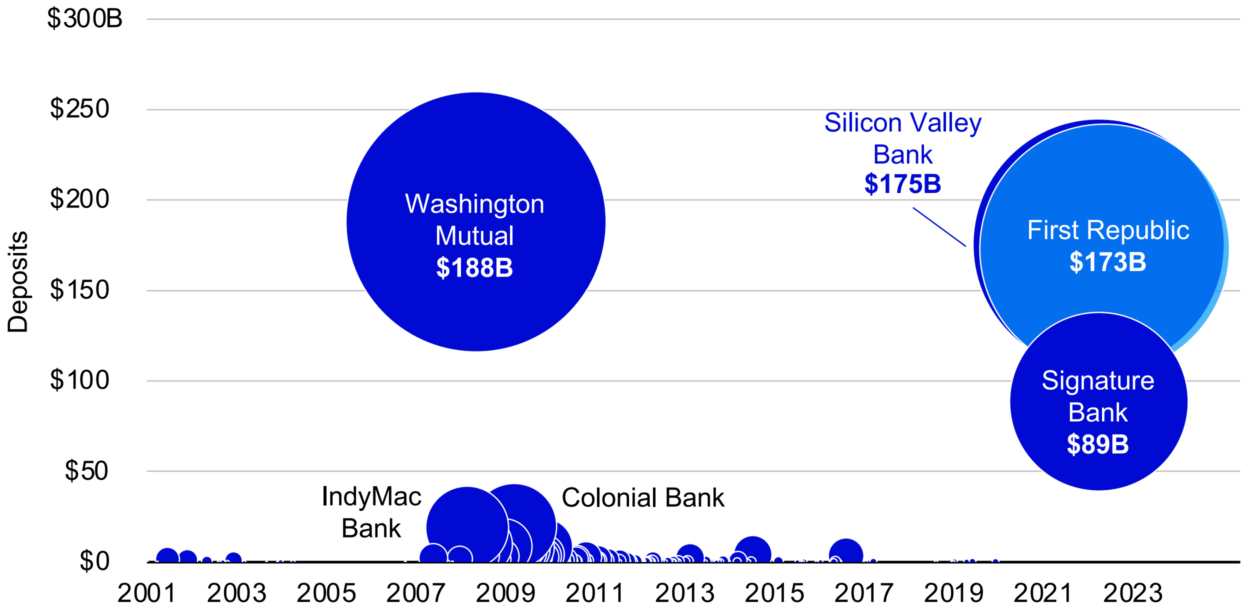
Source: US Federal Reserve, 4/30/23. The federal funds rate is the rate at which banks lend balances to each other overnight. Quantitative tightening (QT) is a monetary policy used by central banks to normalize balance sheets.

The US banks that have failed have been large

Bank failures aren't rare. Since 2001, there have been 565 bank failures!

The First Republic, Silicon Valley Bank, and Signature Bank failures are three of the largest bank failures by deposit size on record, and the biggest since Washington Mutual in 2008.

US bank failures by deposits (2001–2023)



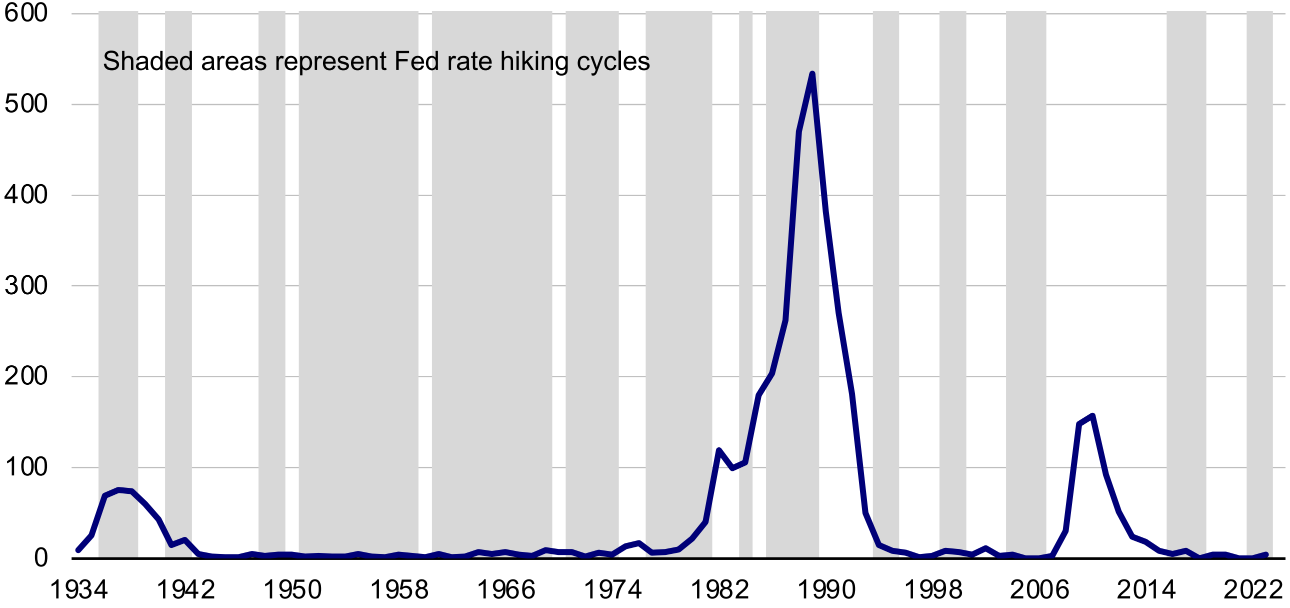
Source: Federal Deposit Insurance Corporation, 4/30/23.

Most of the past crises didn't result in systemic failure

Not all crises, however, resemble the 2008 financial crisis.

Despite all the "financial accidents" that occurred across each of the Fed tightening cycles, there have only been three instances in modern US history of systemic bank failure — the 1930s, the late 1980s, and the late 2000s.

US bank failures: Number of banks (1934-April 2023)



Source: Federal Deposit Insurance Corporation, 4/30/23.

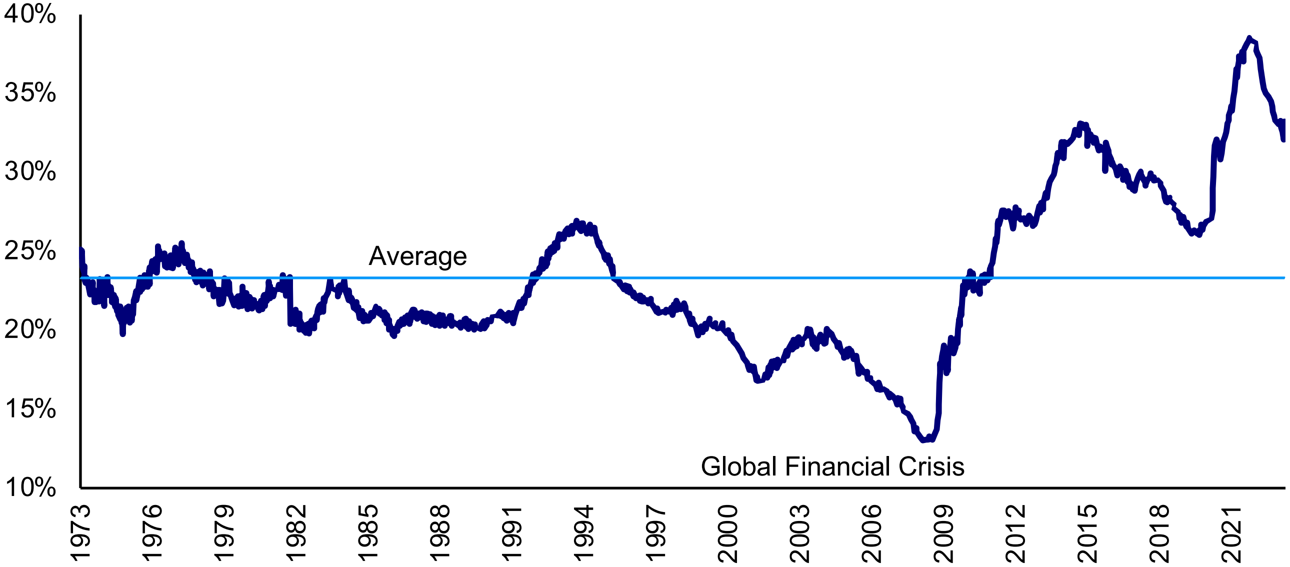
Banks appear to be healthier than during the Global Financial Crisis

Bank balance sheets appear to be sound as they are heavily comprised of high-quality and liquid assets, such as US Treasury bonds and cash.

The health of bank balance sheets is a fundamental difference between 2008 and today.

A central feature of the 2008 Global Financial Crisis was that many of the nation's largest and most interconnected banks had levered exposure to the US housing market. Assets were worth far less than stated, and the leverage was significantly greater than had been claimed. The banks failed because of bad loans and poor credit underwriting.

Commercial banks:
US Treasury, agency securities, and cash as a percent of total assets



Source: US Federal Reserve, 4/19/23. Latest data available.

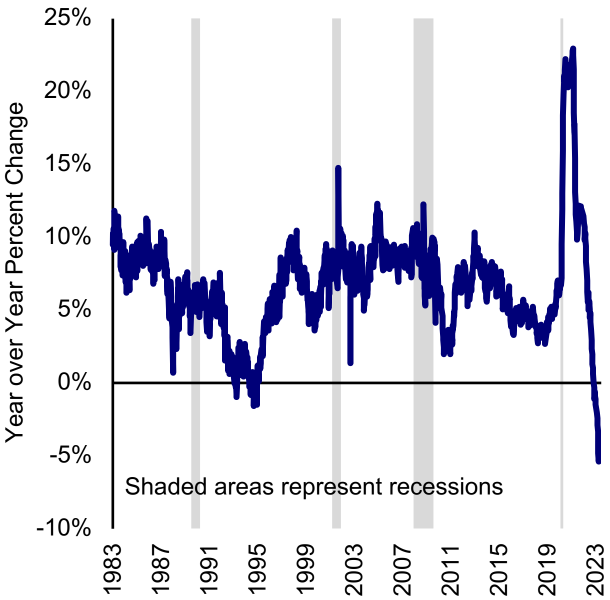
Crisis of confidence resulted in deposit flight

Ironically, specific banks have been challenged, not because of lax lending standards, but in certain instances because of potential recognized losses when/if forced to sell their US Treasuries to match deposit flight.

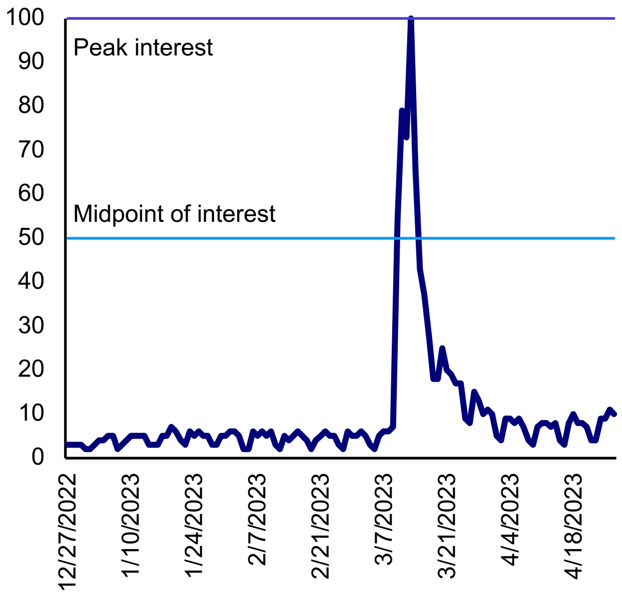
A crisis in confidence has led to negative deposit growth and a recent surge in interest regarding deposit insurance.

Note: Google searches of FDIC insurance have abated meaningfully in recent days.

Deposits



Google search of Federal Deposit Insurance Corporation (FDIC)



Sources: US Federal Reserve, 4/19/23 and Google search, 4/30/23.

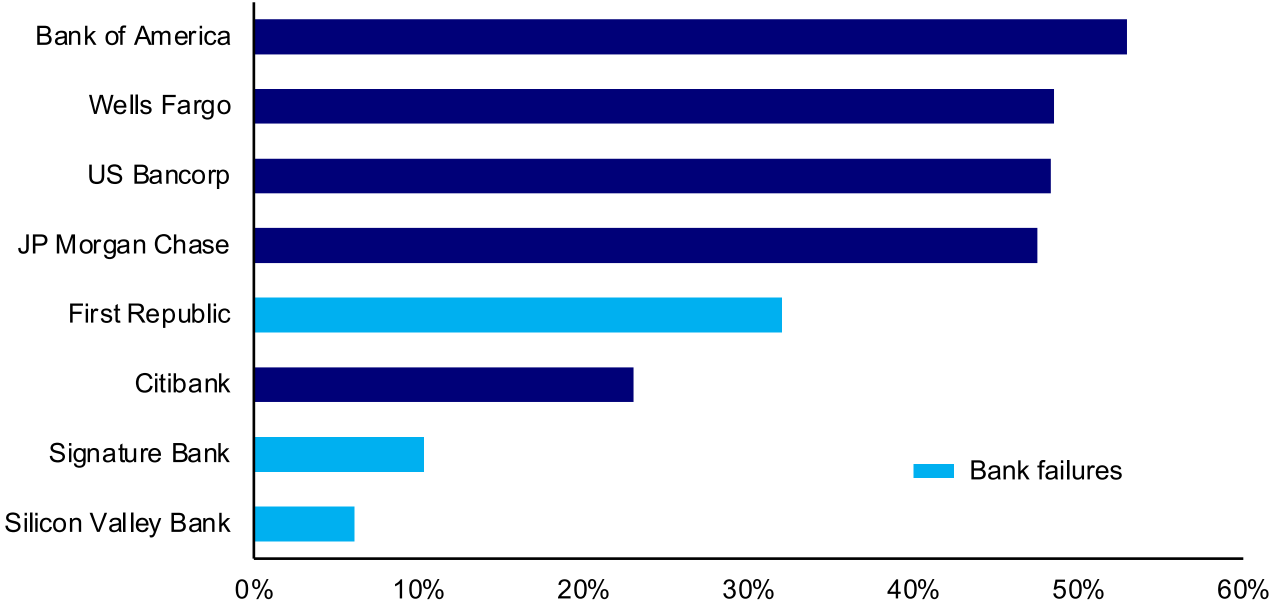
Silicon Valley Bank and Signature Bank were outliers

Concerns over the safety of deposits are likely waning for a couple of reasons.

1. In many of the large money center banks, a large percentage of the deposits are below the $250,000 FDIC insurance threshold.

And…

Share of deposits less than $250,000 as percentage of total deposits for select banks



Source: Federal Deposit Insurance Corporation, 4/30/23.

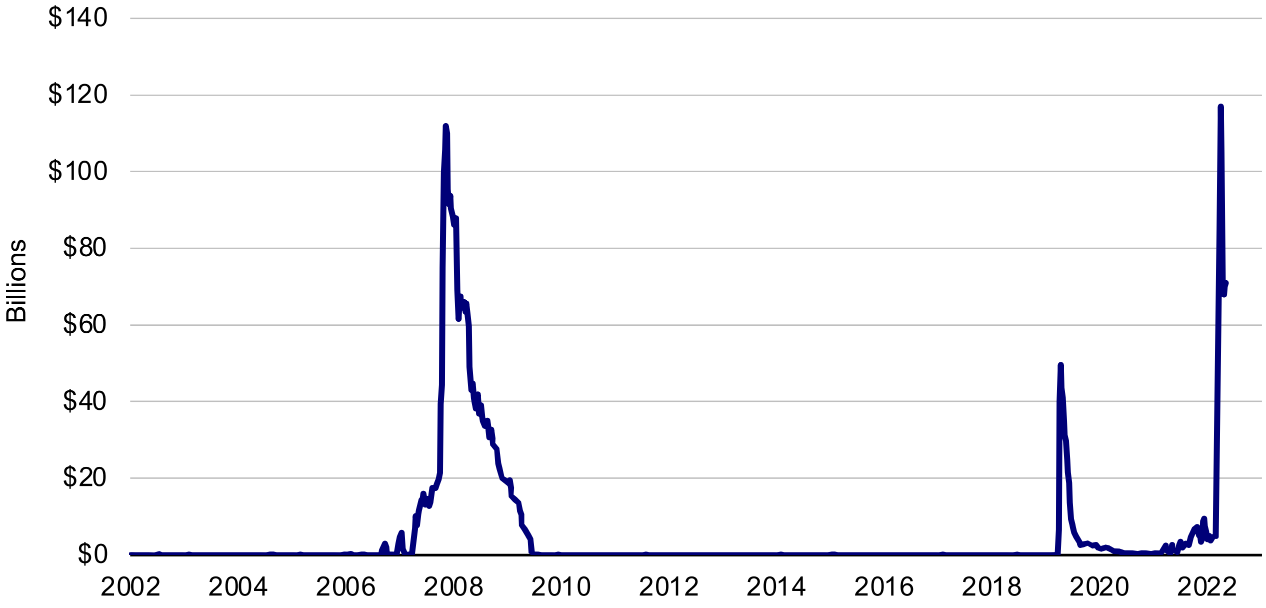
Policymakers are providing ample liquidity to banks

2. …the US Federal Reserve has stepped forward to provide substantial liquidity support to the nation's banks.

Banks were initially borrowing more money at the Fed's discount window than they did at any point during the 2008 Global Financial Crisis, although it has moderated in recent weeks.

While that could potentially be viewed as a stark indication of the liquidity challenges plaguing the banks, it's also a reminder of the support that the Fed is providing to banks to assist them through this period.

Federal Reserve credit and liquidity programs



Source: US Federal Reserve, 4/26/23.

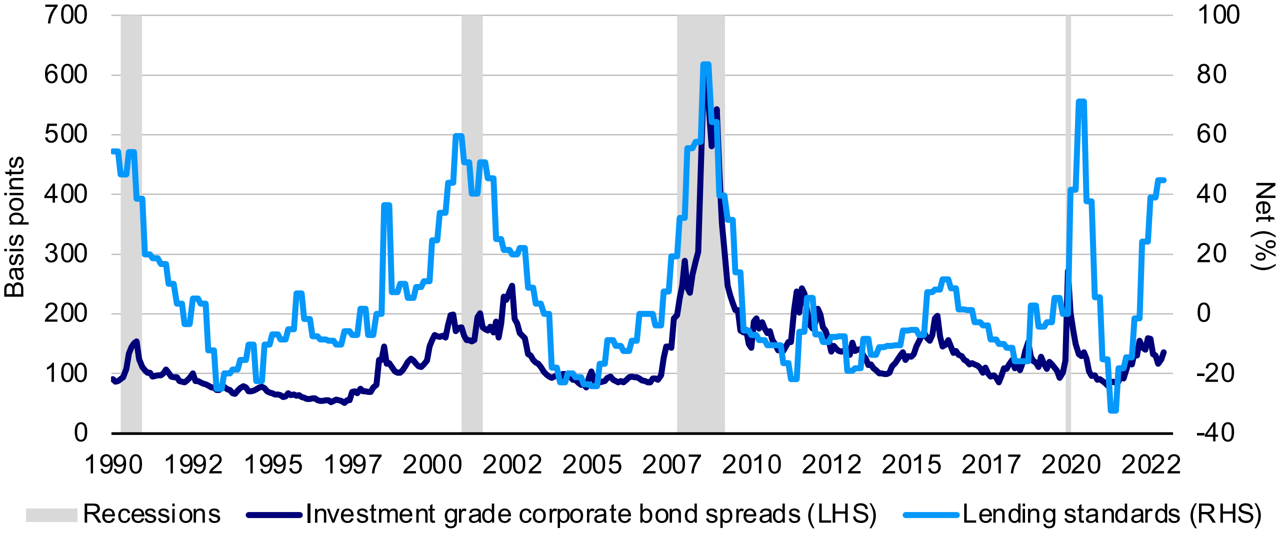
Risks of a recession are elevated as banks tighten lending standards

Is a recession inevitable?

Banks were already tightening lending standards prior to the recent bank failures. It's expected that lending standards will tighten further, which raises the likelihood of a US recession.

Historically a tightening in lending standards has led to higher corporate borrowing costs as well as a downturn in US economic activity.

Senior Loan Officer Opinion Survey: Net percent of domestic respondents tightening standards for commercial and industrial loans (C&I) for large/medium businesses and corporate borrowing costs

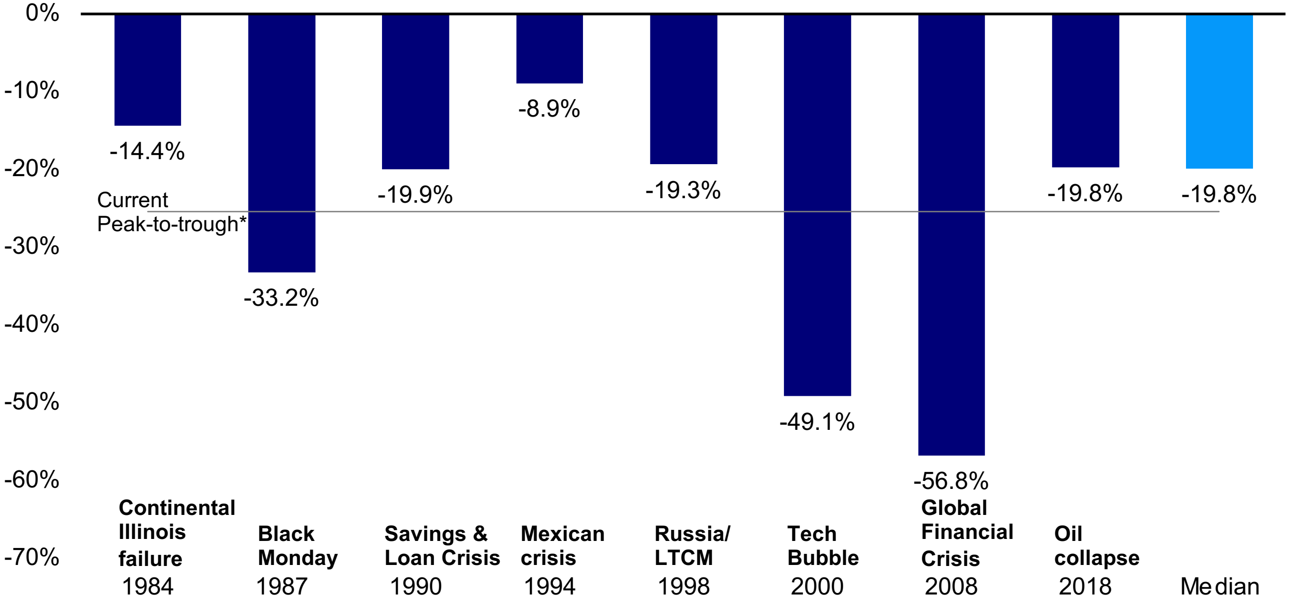


Source: US Federal Reserve, 1/31/23 (latest data available) and Bloomberg L.P., 4/30/23. Investment grade corporate bonds are represented by the Bloomberg US Corporate Bond Index. The option-adjusted spread (OAS) is the measurement of the spread of a fixed income security rate and the risk-free rate of return, which is then adjusted to account for an embedded option, such as calling back or redeeming the issue early. The Senior Loan Officer Opinion Survey on Banking Lending practices is a survey of up to 80 large domestic banks and 24 US branches and agencies of foreign banks. Indexes cannot be purchased directly by investors. **Past performance does not guarantee future results.**

Latest peak-to-trough decline in US equity market resembles those of less severe financial crises

The US stock market has already fallen peak-to-trough by over 25%, worse than the median return associated with these past crises.

S&P 500® Index: Peak-to-trough return associated with select crises



Source: Bloomberg L.P., 12/31/22. The S&P 500 Index is a market-capitalization-weighted index of the 500 largest domestic US stocks. Indexes cannot be purchased directly by investors. **Past performance does not guarantee future results.** *Represents returns from January 3, 2022 to October 13, 2022. There's no guarantee that 10/13/22 is the trough for this cycle.

Returns have been relatively strong at the end of Fed tightening cycles

Historically, crises have tended to end when the US Federal Reserve stops raising interest rates. The recent challenges in the US banking system suggest that the end of rate hikes may be near.

Historically, US equities have tended to perform well (with a few exceptions) in the 1-, 2-, and 3-year periods following the end of the rate hiking cycles.

S&P 500® Index: Returns following the end of tightening cycles

End of Fed hiking cycle	Fed funds rate	1 year after	2 years after (annualized)	3 years after (annualized)
Aug 1984	11.75%	18.2%	28.3%	30.3%
Feb 1989	9.75%	18.9%	16.72%	16.5%
Feb 1995	6.00%	35.6%	30.3%	31.9%
May 2000	6.50%	-10.6%	-12.2%	-10.9%
Jul 2006	5.25%	16.1%	1.6%	-6.1%
Dec 2018	2.50%	31.5%	24.7%	26.0%

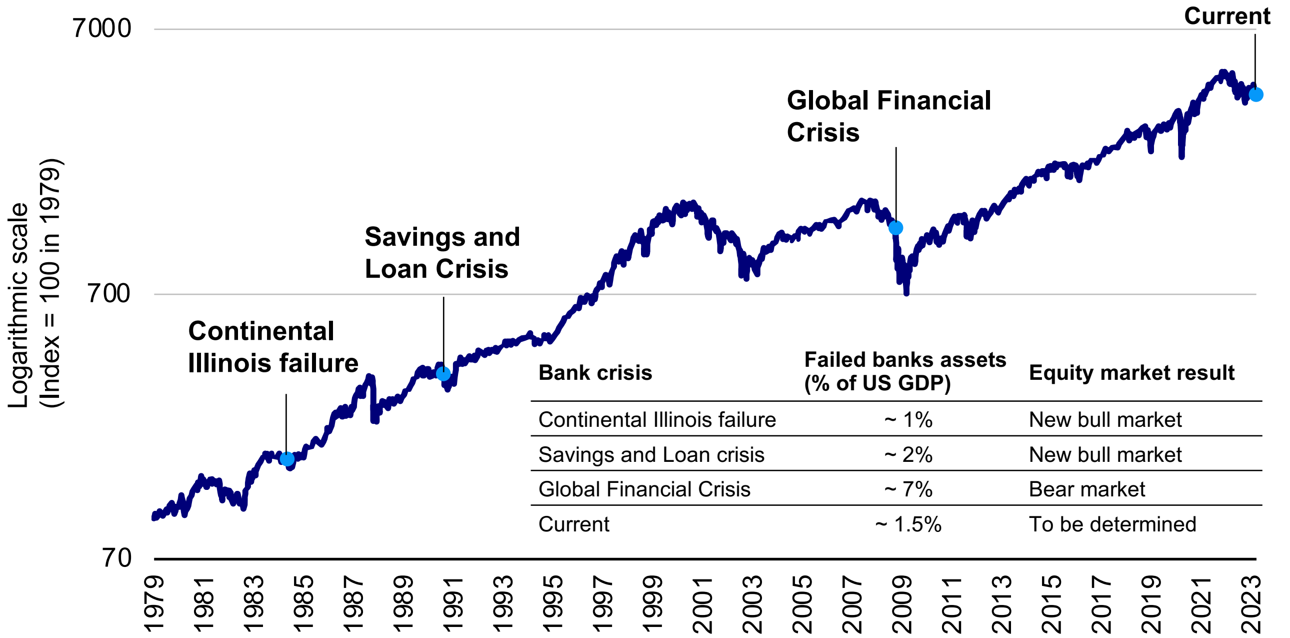
Source: US Federal Reserve, 4/30/23. The S&P 500 Index is a market-capitalization-weighted index of the 500 largest domestic US stocks. Indexes cannot be purchased directly by investors. **Past performance does not guarantee future results.**

Banking crises may represent the beginning of new market cycles

Bank failures could potentially mark the end of market downturns and the beginning of new market cycles. That was the case in 1984 with the Continental Illinois failure as well as in the early 1990s following the Savings and Loan crisis.

The Global Financial Crisis is an outlier and represents a tail risk to an optimistic view. The 2008 crisis, however, engulfed banks with assets representing roughly 7% of US gross domestic product (GDP). The current crisis has thus far impacted fewer and smaller banks than in 2008 and may better resemble the crises in 1984 and 1990.

S&P 500® Index: Growth of 100



Bank crisis	Failed banks assets (% of US GDP)	Equity market result
Continental Illinois failure	~ 1%	New bull market
Savings and Loan crisis	~ 2%	New bull market
Global Financial Crisis	~ 7%	Bear market
Current	~ 1.5%	To be determined

Sources: US Federal Reserve, US Bureau of Labor Statistics, Bloomberg L.P., 3/28/23. The S&P 500 Index is a market-capitalization-weighted index of the 500 largest domestic US stocks. Indexes cannot be purchased directly by investors. **Past performance does not guarantee future results.** GDP is gross domestic product, the total value of goods and services produced in a year.

Index definitions

The S&P 500® Index is a capitalization-weighted index of 500 stocks intended to be a representative sample of leading companies in leading industries within the US economy.

The Bloomberg US Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by US and non-US industrial, utility and financial issuers.

Indexes are unmanaged and cannot be purchased directly by investors. Index performance is shown for illustrative purposes only and does not predict or depict the performance of any investment. **Past performance does not guarantee future results.**

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- Treasury securities are backed by the full faith and credit of the US government as to the timely payment of principal and interest.
- The risks of investing in securities of foreign issuers can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

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