

# Market and Portfolio Update: Collapse of Silicon Valley Bank

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## What has happened so far?

In terms of market capitalization Silicon Valley Bank (SVB) was, until recently, the 15th largest bank in the USA. Because of high losses on its bond portfolio and subsequent massive withdrawals of customer deposits, SVB's capital resources were wiped out, so that the bank could no longer meet its obligations. An emergency injection of capital failed to save it. Last Friday SVB shares suffered substantial losses and were suspended from trading. As a consequence SVB was placed under state control.

Two other banks, Silvergate Bank and Signature Bank, were likewise closed last week. These banks are considerably smaller, however, specializing in niche markets like the crypto industry. Their bankruptcy will therefore have a much lighter impact, and we will focus on the failure of SVB.

The Fed, The US Treasury Department and the Deposit Insurance Corporation FDIC took numerous measures over the past weekend. The FDIC, for instance, guaranteed all deposits placed with SVB. Normally, only deposits up to a value of USD 250,000 are guaranteed. The measures taken are intended to strengthen trust in the banking sector and prevent further bank failures.

## How have the financial markets reacted?

The financial markets reacted with volatile price movements. The US S&P 500 share index lost about 4% in the last three days of trading. The MSCI USA bank index lost a hefty 14% in the same period. Fearing spillover effects, the stock markets in other regions also experienced losses. The European stock market fell by 4%.

The bond markets similarly suffered strong price fluctuations. Yields on 10-year US government bonds fell by 4% to 3.50%. Yields on short-term government bonds dropped even more sharply. Yields on 2-year US government bonds decreased from 5% to 4%. Similar movements were registered on the bond markets in other regions.

## How high is the risk of a systemic bank crisis?

The developments on the financial markets in the last few days can be attributed mainly to fear of a systemic banking crisis.

Because of its business model, however, the SVB was particularly at risk from a strong cycle of increasing interest rates and a slowing down of economic growth. The SVB had a business model with a strong focus on financing mainly start-ups and venture-capital companies. Because of the interest-rate increases, these companies had especially high liquidity needs. In addition, SVB's bond portfolio was very much larger by comparison

with the value of the bank's total assets than is the case for other banks. For that reason the effects of the bond portfolio losses were significantly more serious than was the case for other banks.

In our opinion the risk of a systemic banking crisis, such as occurred in the wake of the global financial crisis, will be relatively low in the coming months. Systemically relevant banks in particular are well capitalized and have diversified business models.

### **Our portfolios**

Our portfolios were not able to completely evade the negative market environment, but losses were somewhat diminished by our tactically defensive positioning.

Since the beginning of the year our Income Portfolios have gained about 0.3%. Our Balanced Portfolios increased in value by about 0.1%. In this period our Growth Portfolios have lost about 0.1%.

### **Outlook**

In our view the market price fluctuations of the past few days seem exaggerated. The risk of a systemic bank crisis is distinctly lower than in the years 2007 to 2009.

Yields have fallen sharply on the bond markets. Two-year yields are even down by more than 1% point. This implies that the market expects that the US Fed will not only very soon end the cycle of interest-rate increases but will already embark on aggressive interest-rate decreases in the second half of the year. We consider this to be very unlikely.

In our opinion the central banks will continue to combat inflation and undertake further interest-rate hikes. This might well considerably slow down economic growth in the coming 12 to 18 months. The risk of recession is thus increased. Since in particular risky asset classes like shares have not priced in a recession, we are maintaining our current underweight in stocks. We do not rule out further stock market corrections.

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