A Pause to Reflect

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Many of us who lived through the financial crisis of 2008-2009 had flashbacks to that era. The collapse of Silicon Valley Bank and Signature Bank also raised concerns about the underlying health of bank balance sheets, particularly for the smaller firms.

We were reminded of how customer confidence is everything for depository institutions. Banks exist because depositors have faith their money is safe. Financial assumptions are made that only a fraction of them will want to withdraw cash at any one time. When that changes no bank, including JP Morgan Chase, can withstand everyone lining up at the teller window.

Some argue about moral hazard and the Fed rescuing mismanaged companies. But the drop regional bank stock prices took even *with* the full support of the Fed pointed to the potential damage the financial system would have suffered had there been anything short of a backstop.

It’s also possible, as one US senator recently opined, that loosening of regulatory oversight on banks below $250 billion in assets five years ago contributed to today’s issues. But tech concentration, as with sub-prime mortgages in the past, was at the root of the problem.

We leave to others how investors and depositors will adjust to these events and the options open to them. It’s premature to predict how this crisis will unfold, or whether the worst has past. Suffice it to say that the largest financial institutions are likely to benefit from customers’ flight to quality, and smaller ones will be challenged regardless of reputation.

In one sense, a key lesson asset managers learned from the GFC – diversify your financing sources – was well-learned. Credit providers of all stripes stepped up over the past decade or more to provide a multitude of financing options. These allowed private equity and private credit firms to manage their investors and investments with increased efficiency and tool kits.

But expanding capabilities had consequences. Not all financing sources were created equal. And product offerings included not just corporate lines of credit, but also variants such as subscription lines and leveraged facilities.

As a hard, steady rain uncovers leaky roofs, so the drumbeat of soaring interest rates exposed weaknesses in financial structures. We’re discovering the private capital financing ecosystem is a complex web. Managers, investors, and borrowers are interconnected in a dizzying fashion, making assessing of risk a challenge.

A universal message from financial service providers is understanding all ramifications of recent events will take time. Longer term expect credit costs to increase, risk parameters to tighten, and markets to slow. Accordingly a 50 bps hike, or even a 25 bps one, may be off the table for the March meeting.

By its demise SVB may accomplish what the Fed with a year’s worth of tightening has so far been unable to do.