CANDOR ASSET ADVISORS

March 2023 Update: Thoughts on Recent Bank Failures & Stock Market Implications

I hope the first weeks of March have treated you well and you enjoy watching the NCAA College Basketball's March Madness over the coming weeks.

Regarding madness, the last week has been a turbulent time for banks and the financial markets. One big topic has been the failures of Silicon Valley Bank and Signature Bank. What do these failures mean for bank depositors and investors? Below we provide links to some good articles that provide perspective.

After two historic bank failures what comes next - from The Associated Press[i]

Is My Money Safe? What you need to know about bank failures - from The Associated Press[ii]

Below we also provide some analysis on the news' impact on what it means going forward.

- **Your bank deposits should be safe** - The US Treasury, Federal Reserve and Federal Deposit Insurance Corporation (FDIC) realized last weekend the negative impact of Silicon Valley Bank (SIVB) and Signature Bank (SBNY) depositors not being able to get their money back in full was a price they didn't want society to bear. To address this risk, the regulators guaranteed all deposits at both banks[iii]. Worth noting, 93% of SIVB deposits and 90% of SBNY deposits were over $250,000 and not subject to FDIC insurance prior to this statement. These percentages were much higher that most large and regional bank peers[iv]. Thus, a greater percentage of both bank's depositors were skittish that their deposits wound not be protected in the event of a bank failure. To protect other banks from potential bank runs, the Federal Reserve announced a Bank Term Lending Program that allows banks to borrow from the Federal Reserve at the one-year overnight index swap rate plus 10 basis points for one year based on treasury and agency backed securities they own at face value[v]. This mechanism should help prevent bank runs like those that occurred recently. As an aside, the AP article "Is Your Money Safe?" provides some helpful personal banking tips you may want to review and implement if your bank deposits are over $250,000. Following these steps should make losing a substantial portion of these large deposits a low-risk event.
- **Major banks stand to gain deposits from regional banks as depositors seek additional safety** - Since last week Citibank, JP Morgan, and Bank of America have seen an influx in deposits as customers have sought to move money from regional banks[vi].
- **Venture capital funding may be more difficult in the near term** - Silicon Valley Bank was a significant lender to technology and healthcare startups in recent years. In fact, SIVB was involved in 44% of all venture capital funded healthcare and technology companies that went public in 2021 and banked almost 50% of US venture banked tech and life science firms in 2022[vii]. Now these earlier-stage firms will have one less lender to provide them capital. Also, capital raising has become more difficult given higher interest rates.
- **Banks will face earning pressures** - The early innings of rate increases served mostly as a tailwind for banks. Most banks were able to earn higher rates on their assets while credit losses remained in check and deposit cost increases were manageable. Now additional rate increases are causing bank depositors to increasingly shop for better rates. The rise in rates has also caused the bank's debtors to feel more financial stress, and credit losses are starting to accelerate. In addition, bank investments in long dated fixed income securities are showing greater realized or unrealized losses[viii]. We expected bank earnings to be increasingly under pressure due to net interest margin pressures and higher credit losses.
- **Regional banks will likely see increased regulatory oversight and capital restrictions** - The recent failure of Silicon Valley Bank and Signature Bank will likely prompt regulators to require regional banks to undergo further

capital stress tests and potentially require banks to have higher equity relative to assets[ix]. Our work suggests some regional banks will likely curtail further share repurchase or dividend raises for a period of time. Also, other regional banks may have to issue shares to comply with new capital restrictions.

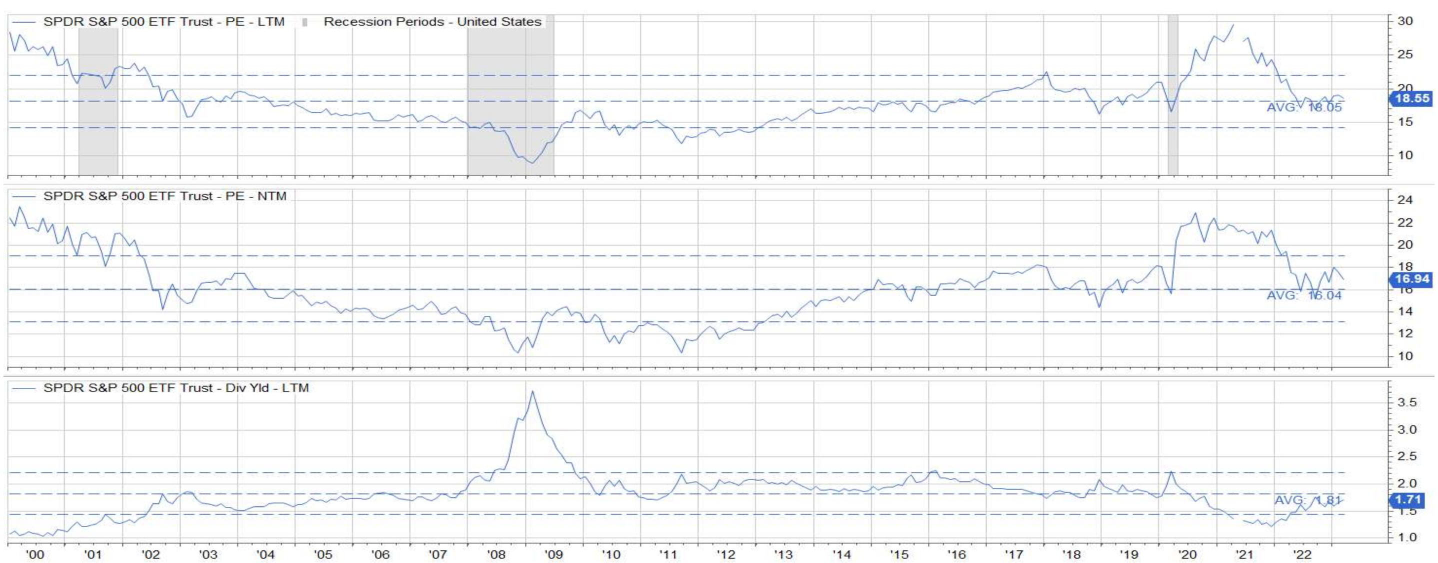
- **Central bankers continue to walk a tight rope between trying to tame inflation and preventing a hard landing. This makes predicting future central bank actions more difficult and increases the potential for policy errors.**
    - On the one hand, recent bank failures underscore that the Fed's rapid rate rise has knock-on effects that are just starting to be fully felt and appreciated. These data points in isolation make central bank officials wary of raising rates too much and for too long[x].
    - On the other hand, inflation remains at stubbornly high levels. US consumer price inflation registered 6% year-on-year in February 2023 and Eurozone inflation registered 8.5% over the same period[xi]. The fact that inflation has persisted at higher levels has emboldened some central bankers to continue to raise rates until inflation is tamed.

Putting the News in Context

So, what does this news mean for your stock investments? Expect a choppy to weak stock market over the near term as recent bank failures underscore the financial stress associated with a rapid rise in rates. We sense stock investors in recent months have been too optimistic that the economy would avert a hard landing. You can see this when you review recent sales, EPS, and dividend per share estimates versus previous recessions.

	Consensus Estimates			Past Recessions	If Recession Starts in	Implied
	2021A	2022	2023E	Since 1990	2023E	Revision
Sales Per Share	$1,535.58	$1,764.70	$1,812.73		$1,769.45	-2.4%
Annual Growth	14.0%	14.9%	2.7%	0.3%		
EPS	$187.05	$204.54	$221.37		$166.94	-24.6%
Annual Growth	56.0%	9.3%	8.2%	-18.4%		
Dividend Per Share	$57.71	$63.86	$69.01		$63.91	-7.4%
Annual Growth	2.4%	10.6%	8.1%	0.1%		

Note, S&P earnings growth recently turned negative for the first time since early 2020[xii]. You can also see investors have been expecting a soft landing when reviewing the S&P's valuation charts. Stock valuations are near historic averages[xiii].

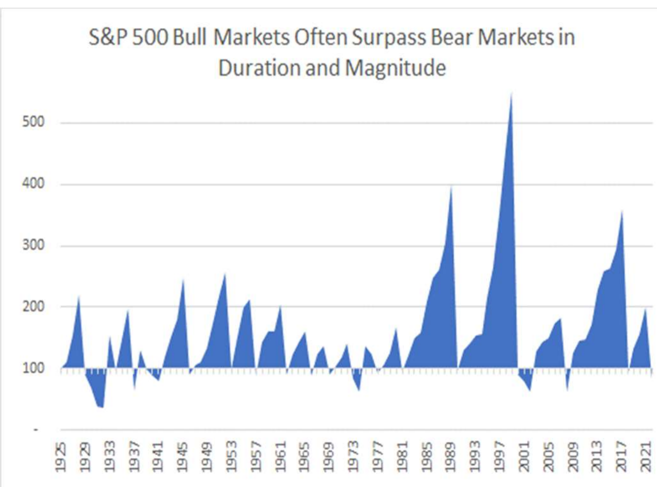


Worth noting, bear markets are often associated with recessions[xiv] and a recession appears increasingly likely. Note, the average bear market decline is 35-40%, and we have only experienced a cumulative 19% decline from recent January 2022 highs[xv].

Bigger picture, we urge investors keep their financial plan investment horizon in mind. The time horizon usually corresponds with your life expectancy adjusted for estate planning considerations. Regarding life expectancy, studies suggest if you are healthy and have an average family healthy history you should probably plan on living until at least your mid 80s to mid 90s[xvi]. This observation suggests if you are:

- Age 30-40 your financial plan time horizon is likely 45+ years
- Age 40-50 your financial plan time horizon is likely 35+ years
- Age 50-60 your financial plan time horizon is likely 25+ years
- Age 60-70 your financial plan time horizon is likely 15+ years
- Age 70-80 your financial plan time horizon is likely 5-15+ years

Worth recognizing is the futility in trying to time the stock market and economic cycle and the importance of staying the course. Notice how stock bull markets often occur longer and are of greater magnitude than stock bear markets[xvii]. Lastly, notice how being out of the market for even short periods of time has negatively impacted returns[xviii,xix].



US stock studies since the 1950s have stressed the same thing: The Importance of Staying Invested

- 1954-1994 Return Study
  - S&P earned a 11.4% annual return
  - If you were out of the market during the best performing days
    - 2% of the time you earned an 8.3% annual return
    - 4% of the time you earned a 6.1% annual return
    - 8% of the time you earned a 2.7% return
- 1980-2018 Return Study
  - S&P earned a 11.65% annual return
  - If you were out of the market and you missed the
    - 5 best days you earned a 10.38% return
    - 10 best days you earned a 9.53% return
    - 30 best days you earned a 6.87% return
    - 50 best days you earned a 4.71% return

The 1980-2018 study assumes an investment tracks the returns of the S&P index and includes dividend reinvestment but does not reflect the impact of taxes, which would lower these figures. "Best days" were determined by ranking the one-day returns for the S&P index within this time period and ranking them from highest to lowest.

Source: Peter Lynch *One Up On Wall Street*, Fidelity

Past performance is not a guarantee or predictor of future performance. Stocks are not guaranteed and have been more volatile than other asset classes. Stocks are not guaranteed and have been more volatile than other asset classes. 31

Please let us know if you have questions or comments,

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To schedule a conversation:

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End Notes

[i] (Sweet, 2023)
[ii] (Morga, 2023)
[iii] (US Department of Treasury, Federal Reserve and FDIC, 2023)
[iv] (Elder, 2023)
[v] (The Federal Reserve , 2023)
[vi] (Demos, 2023)
[vii] (Silicon Valley Bank, 2023)
[viii] (Juneja, 2023)
[ix] (Flitter, 2023)
[x] (Hyatt, 2023)
[xi] (FactSet, 2023)
[xii] (FactSet, 2023)
[xiii] (FactSet, 2023)
[xiv] (Candor Asset Advisors, 2022)
[xv] (FactSet, 2023)
[xvi] (Social Security Adminstration, 2019)
[xvii] (Harrington, 2021)
[xviii] (Lynch, 2000)
[xix] (Fidelity, 2020)

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