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ebi Market update: **Silicon Valley Bank Collapse**

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We welcome feedback on its contents.

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What happened?

- Silicon Valley Bank (SVB) was a commercial bank based in California, and ranked as the 16th largest bank in the US prior to its collapse last week.
- It had built its business around serving venture-capital backed US tech and life sciences companies, with its deposit base growing rapidly as Silicon Valley start-ups attracted significant investment in the low interest rate era.
- SVB had invested a large proportion of these deposits in long-dated fixed-rate bonds securities, leading to significant interest rate risk (which it had not hedged to a meaningful degree).
- The value of these bonds fell, as the Federal Reserve and other major central banks embarked on a rapid interest rate hiking cycle over the past 12-18 months.
- While this fall in value was of limited impact so long as the bank did not crystalise the losses, SVB was forced to sell c.$21bn of these bonds to raise funds to meet withdrawal requests, and incurred a loss of at least $1.8bn.
- On Wednesday (8th March) SVB attempted to shore up its capital base through a $2.3bn share sale. However this was unsuccessful and triggered heightened concern around the stability of the bank, added to by a separate (cryptocurrency-focused) lender, Silvergate, announcing it was winding down operations.
- SVB experienced a significant bank run the following day Thursday (9th March), in which customers withdrew c.$42bn of assets (a quarter of total deposits).
- Given the magnitude of these withdrawals, SVB ultimately failed on Friday (10th March), with its demise ranking as the second largest failure in history of a federally insured US bank, second only to the 2008 failure of Washington Mutual.

What was the response from government and regulators?

- On its failure on Friday, SVB was taken into receivership by the Federal Deposit Insurance Corporation (FDIC), which plays an equivalent role to the UK’s Financial Services Compensation Scheme (FSCS).
- This led to inevitable questions regarding the expected outcome for SVB’s customers’ deposits – standard FDIC protection stands at $250k per depositor, per insured bank. However, some estimates suggested that the proportion of SVB’s deposit base in excess of this limit (and therefore unprotected by the FDIC guarantee) as more than 95% of SVB’s total deposits.
- The FDIC was active in leading an auction over the weekend to seek a potential buyer for the bank, however this was ultimately unsuccessful.
- On the evening of Sunday (12th March), US regulators carried out a significant intervention and announced that SVB depositors would be repaid for the full amount of their deposits (i.e. backstopping all deposits, including those in excess of the $250k FDIC guarantee).

- At the same time the Federal Reserve (the Fed), in coordination with the US Treasury and the FDIC, announced other measures to shore up the stability of the banking system, including providing extra funding to eligible institutions to ensure that "banks have the ability to meet the needs of all their deposits".

- Regulators also acted in relation to Signature Bank of New York (a separate US bank, with a customer base concentrated in the tech and cryptocurrency industries), closing the bank and putting it under FDIC control. In a similar fashion to SVB, regulators announced that customers would have access to their deposits the following working day.

- Finally, this side of the Atlantic, SVB's UK arm (which the Bank of England (BoE) had announced it had planned to put into insolvency following the collapse of its parent company SVB) was sold to HSBC for a symbolic £1, with the deal facilitated by the government and the BoE.

What is the impact of on ebi's portfolios and wider markets?

- ebi builds highly diversified portfolios broadly reflective of global markets, seeking to enhance risk-adjusted returns through a factor-based approach.

- As such, the equity element of ebi portfolios held only extremely marginal exposures to SVB and Signature Bank, resulting from the presence of these stocks on major stock exchanges (specifically, the NASDAQ). For example, in the Vantage Earth range, as at 28 February 2023 the equity portfolios had a 0.0070% weighting to SVB Financial Group, and a 0.0041% weighting to Signature Bank.

- These exposures are reflective of the small relative size of these banks compared to some of their significantly larger competitor firms in the US banking industry (e.g. JPMorgan Chase, Wells Fargo, Bank of America, and Citigroup).

- As such, the impact of the two holdings on the performance of ebi's portfolios is small, equivalent to the movements we might see in a typical day in the portfolio.

- While we are understandably seeing increased stress on the wider banking sector, these developments may lead to further accommodative measures from central authorities, including the Fed potentially slowing their monetary tightening plans.

- For example, prior to the events outlined above, futures markets were suggesting the likely outcome of the Fed's 21st/22nd March meeting as a 0.5% hike in interest rates. While following these events, futures markets are implying a c.75% likelihood that the Fed will hike rates by only 0.25% at the March meeting, with some market participants expecting the Fed to hold steady, and others even calling for a rate cut.

- At ebi we believe that attempts to actively manage portfolios (including attempting to time the market) are on the whole futile, and believe that a well-designed strategic allocation, executed through a globally diversified portfolio, is what drives returns over the long-term.

- To summarise, while the events of the last week have been a concern, our message to clients remains the same – investors in globally diversified portfolios such as those offered by ebi are well-positioned for a wide range of market outcomes, and the ups and downs experienced as part of the investment journey.

- If you would like a sales aid to support you with explaining this investment journey to clients, please refer to the Bull and Bear chart, which can be found in the ebi Repository.

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