

# Should investors fear the aftermath of the collapse of the Silicon Valley Bank?



## Market context

A sharp fall in the banking sector and in equity markets followed the announcement of a recapitalisation of Silicon Valley Bank (SVB), a regional bank in California. On the evening of Thursday 9 March, the S&P 500 Index fell by 1.8% on the news, with the S&P 500 Banks Index shedding 6.6%. The European session opened sharply in the red on Friday (at around -2%) before picking up slightly. On Monday morning, European stock exchanges fell by around 3%.

## What happened?

Silicon Valley Bank specialises in lending to start-ups and young technology companies. This high-risk business has become even riskier since rates started to rise a year ago.

Its business model is causing a continual fall in cash as the companies it partners with are using their cash. **In order to face cash withdrawals, SVB recently disposed of part of its fixed income investments, at a loss, thus putting a strain on its capital. In a bid to shore up its finances and guarantee long-term solvency, SVB had decided to increase its capital by USD 2.25 billion by issuing new shares.**

On this news, the stock plummeted 60%, and the entire US banking system was shaken in the markets. Obviously, this raises questions about the liquidity of the banking system in general and potential contagion risks. During the weekend (11-12 March), the American regulator finally decided to take control of SVB by guaranteeing customer deposits and allowing cash withdrawals. The bank is opening today (Monday) even though the share has been suspended on the stock market.

## Should investors fear contagion to the US banking system?

**Not really.** Generally speaking, major US banks have very healthy liquidity positions and therefore do not need to sell bonds to guarantee their liquidity. **SVB is a singular case and its woes are due to its particularly poor cash and balance sheet management** (especially in view of its business model and customer-base).

In general, there has been a liquidity squeeze in the US banking system, but this came on the back of a huge increase in deposits following the cheques the US administration had sent to American households during the COVID-19 crisis as an economic stimulus measure.

The balance sheets of major American banks are healthy. However, a few small US regional banks may have mismanaged their balance sheets, which would not be statistically unusual given the large number of US regional banks. In fact, it appears that some other small financial institutions in California are suffering from deposit outflows. This is not surprising given the context.

**Overall, credit default swaps (CDS) of American banks have widened around 30-40bp. In addition we are still some way off the peaks reached in October during the crisis surrounding the restructuring of Credit Suisse.**

**Credit spreads of quality issuers have increased by around 0.1% and those of lower quality by around 0.5%. In other words, very little. Large US banks could even benefit from the situation if customers were to move their deposits from beleaguered banks.**

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## Should investors fear contagion to the European banking system?

This scenario is even less likely. In general, CDS of European banks have barely widened. They have generally NOT increased their bond allocations in recent years and their balance sheets are suffering relatively less from rising bond yields. On the contrary, their now very strong balance sheets allow them to lend again under more favourable terms than they had offered for many years, while their own financing, mainly via customer deposits, remains very cheap.

Moreover, few European banks specialise in niches like Silicon Valley Bank. European banks are usually more diversified and well regulated.

## Other consequences

Paradoxically, this crisis could prove positive for equity markets if, for example, the American Federal Reserve were to temper its monetary tightening policy to boost liquidity and market confidence.

This event highlights the risks of investing in smaller companies that are not always transparent or well managed. **The short-term impact could therefore be a return of investor appetite to quality companies with solid balance sheets and sufficient cash, after the early 2023 trend of a new appetite for risk and for lower-quality companies.**

**More illiquid and risky investments, on the other hand, should see their risk premiums increase.** During the weekend (11-12 March), after the US regulator took control of SVB, we learned that it was setting up a liquidity/refinancing mechanism for banks in difficulty: eligible institutions will be able to obtain liquidity (in the form of loans of up to one year) against bonds in portfolio at a valuation level of 100%, and not at market value.

### CONCLUSION

The rapid decisions of support made by the US authorities to ensure liquidity and stem a systemic panic movement are a step in the right direction.

We expect this event to remain relatively under control. We will be monitoring the developments over the coming days and weeks, notably to see if we need to change our Positive opinion on the banking sector (which is undervalued despite seeing an explosion in profits due to an unprecedented increase in net interest margin).

For the time being, we still prefer European banks to US banks.

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