Confidence matters. That's true of most areas of life, but it's especially true in banking. Bankers have known this for years.

Recently, I read a story of how banker Marriner Eccles prevented a run on his Ogden bank in 1929, the beginning of the Great Depression. As jittery citizens lined up to withdraw money from Eccles' bank, he told employees to go about business as usual with a smile, but to hand out cash very slowly to avoid depleting the bank's funds. When the bank's cash delivery arrived later that day from the regional Fed branch, Eccles made a speech to reassure customers that there was plenty of currency to meet their requirements (he did neglect a few details). The next day, Eccles told his tellers to handle transactions quickly. No lines were to form, and none did. Customers arrived, saw a peaceful lobby, and that was the end of a potential run. The citizens of Ogden stopped worrying that money wouldn't be accessible. Eccles would later be appointed Chairman of the Federal Reserve by President Roosevelt.

This story in Jeanna Smialek's book ***Limitless***, about the evolution of the Federal Reserve, renewed my confidence. Essentially, The Federal Reserve did something similar last month, preventing bank runs spurred by the failures of Silicon Valley Bank and Signature Bank by quickly guaranteeing deposits beyond the Federal Deposit Insurance Corp.'s $250,000 limit per customer. Now U.S. bank customers feel more secure about being able to withdraw funds, even if they aren't customers of large, well-capitalized banks. And in a March 22nd press conference, Fed Chairman Jerome Powell followed the Fed's decision to raise its short-term interest rate target by 25 basis points (0.25% basis points) with the statement, "Deposit flows in the banking system have stabilized over the last week." Of course, continued stability depends on no policy surprises.

I approve of the Fed's actions to stabilize the banking system, but I am not happy with the quality of the Fed's oversight of banks like Silicon Valley Bank. The bank made a mistake that even a rookie investment management professional or bank examiner should recognize. It invested funds from short-term deposits in long-term Treasury bonds because the bank wanted higher returns than were available on short-term fixed income.

There's nothing wrong with seeking higher returns. The problem is that the bank didn't consider the risks that come with higher returns—a topic of which I'm very aware because I always seek to protect my investors' capital. Silicon Valley Bank had a massive liability-asset mismatch between the "duration" of its deposits and the Treasury holdings that made up a large portion of its assets. Duration refers to the timing of when fixed-income investments will be fully repaid. Bank deposits should be paid to depositors upon request; the duration of Treasury bonds is measured in years. The longer duration makes Treasury Bonds' price vulnerable to increases in interest rates because they become less attractive to buyers as investments paying higher yields become available. In contrast, one dollar's worth of bank deposits should always be worth $1. That's why Silicon Valley Bank collapsed when it couldn't pay depositors with its Treasuries that had fallen in value due to the fastest interest-rate hikes in modern times. Silicon Valley Bank should never have invested so heavily in long-term Treasuries.

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It appears to me that the Fed has successfully stabilized the banking system, at least for the foreseeable future. But that doesn't mean that I'm looking to invest in banks. I did not hold any bank stocks at the time of the recent banking crisis, and I do not intend to add any bank stocks now, despite the sharp decline in prices that followed the news about Silicon Valley Bank and Signature Bank and no matter how cheap banks become. While this contrasts with my reaction to the collapse in the price of oil during the pandemic, the difference is, that I saw a reason—the mismatch of supply and demand—for energy stocks to move higher. I don't see a catalyst that will drive bank stocks to new heights.

On the other hand, I'm not overly worried about what lies ahead. There's still a possibility that the Fed will guide the economy to a "soft landing," avoiding recession. Fed Chair Powell sees a "pathway" to a soft landing.

A positive factor that Powell didn't discuss is the return of China to full production following the end of its zero-COVID policies. Renewed production should improve the supply chain and help to ease inflationary pressures. Also, the Chinese government's policy shift is benefiting business and should also help the global economy.

My research on commercial real estate also reassures me. I had wondered if commercial real estate could become a source of systemic risk to the U.S. financial system as interest rates rise and loans need to be refinanced at higher rates. However, most commercial real estate loans are for five, seven and 10 years. Assuming that the borrower holds a good property and is paying down the principal, if the loan comes due at higher rates, the new payment should be about the same, so the payment might be bearable—assuming tenants are still paying rents on fully occupied buildings.

We will continue to closely monitor Fed policy. The Fed might pivot away from interest-rate hikes. Indeed, Powell said that before its March meeting, the Fed considered pausing its rate hikes.

In this environment, I'm not buying or selling many positions. When cash comes in, I add to existing positions. We bought a number of securities cheaply last year, and I still have confidence in those positions.

Bond prices have suffered because of investors' concerns about higher interest rates. Those lower prices make some bonds look like better buys. I am looking at buying more municipal bonds.

Also, if good stocks experience price declines, I'll look at opportunities there, particularly if the stocks are attractively priced or if the companies are those we believe will be tomorrow's winners due to their investment in new technologies.

As always, thank you for the trust you have placed in me and in 7Summit Advisors. We work hard to earn that trust each day.

Sincerely yours,

Li Chang

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