INVESTOR'S EDGE

Banking crisis shouldn't hurt regional banks

Falling inflation is bullish sign for the markets.

"Banking is a very good business if you don't do anything dumb."
— Warren Buffett

Jim Burns CFA
Guest columnist

They say timing is everything.

Last month, I recommended Community Bank stock. Just one week later, shockwaves started within the U.S. banking system with the collapse of SVB Bank and Signature Bank.

I've been left wondering, why didn't my readers tell me this was about to happen? LOL

Seriously, in many ways, I have been proven right in my original analysis, as Community Bank is down "only" 10% since my column while the regional bank indices are down around 30%. My investment thesis then, and now, was that Community Banking System has well-diversified revenue streams and conservative depositors.

So, for the record, I stand by my recommendation of Community Bank and believe it will be a solid long-term investment.

In today's column, I will give an overview of what has happened in the banking system and my outlook going forward.

As mentioned, Silicon Valley Bank, a prominent bank amongst tech companies and venture capitalists, collapsed and was seized by the federal government in early March. This marked the largest U.S. bank failure since 2008.

In essence, Silicon Valley Bank owned mostly long-term government bonds to generate cash to cover their deposits. These bonds were purchased when interest rates were close to zero. However, as interest rates rose sharply in 2022, the value of these bonds dropped significantly.

Furthermore, as the economy started to weaken, venture capitalists, startups, and technology companies began to need more liquidity to cover their debts and expenses. This pace accelerated dramatically as concern increased about SVB's ability to pay their depositors. On March 10, the bank collapsed.

Just a day later, Signature Bank — a bank heavily exposed to cryptocurrencies — experienced a similar panic amongst its depositors and saw more than $10 billion in outflows. It was shut down by the U.S. government hours later.

As a result, that weekend the Federal Reserve stepped in with the controversial move of guaranteeing 100% of deposits held at SVB and Signature Bank, over and above the $250,000 cap insured by FDIC.

Unfortunately, it is estimated that 90% of deposits at SVB and Signature Bank did not have FDIC insurance.

Related to my Warren Buffett quote above, that is "doing something dumb."

In its wake, investors and depositors alike are understandably concerned about the banking system as a whole and wondering if what happened to SVB will spread to other institutions, particularly the regional banks.

While there is a lot of fear out there, I do not think what happened with SVB and Signature Bank is likely to become a contagion across the banking system. Here's why:

- SVB and Signature Bank had unique business models, in SVB's case catering exclusively to VC firms and Signature Bank with having large cryptocurrency exposure. These esoteric anomalies are not common in the wider banking system, even among regional banks.
- The Federal Reserve has mobilized not only to guarantee 100% of the deposits at SVB and Signature but has stepped in to offer liquidity to the smaller regional banks to prevent another crisis.
- The large commercial banks must undergo "stress tests" to ensure they are adequately capitalized. These stress tests are like the last three recessions combined and the banks must pass them annually. In essence, the large banks are more stable, regulated, and well capitalized than they were in 2008.
- As far as the European banks, they are currently the best capitalized and most profitable they have ever been. On top of this, Credit Suisse, which has been in the news, has always been a deeply troubled institution — for well over a decade.

I am quite confident that the systemic risk to the banking system is low, and even in a worst-case scenario, the federal government will step in and ensure depositor's assets, even those above the FDIC's current $250,000 threshold. There is no appetite anywhere for a run on the banks as what occurred during the Great Depression.

From an investment standpoint, the stock market will continue to be sensitive to any further news surrounding these issues and other economic data.

POSITIVE TAKEAWAYS

However, once these clouds pass, there are some positive takeaways for the market heading into the spring/summer of 2023. Namely, after raising interest rates at their fastest pace in history, it seems likely the Fed will rethink its pace of future rate hikes and bring into play a potential sooner-than-expected pause.

Importantly, inflation is trending down and should continue to drop with the Consumer Price Index data trending lower each month since July 2022. The February Producer Price Index report released recently showed significant drops in producer inflation. In short, inflation is trending down and should continue to drop — bullish for stocks.

In summary, some of our readers may recall Jimmy Stewart in the classic 1946 movie "It's a Wonderful Life" where during the Great Depression the local townsfolk step in to save his community bank.

The current situation is nothing like this.

Stay long. And buy Community Bank System's stock at a real discount.

You'll make money.

Jim Burns, a chartered financial analyst, is president of J.W. Burns & Co. The opinions expressed here are his and do not necessarily reflect those of The Post-Standard. Readers should do research before deciding on an investment. Contact him at jburns@jwburns.com.