Investment Insight
Banking Crisis or Crisis of a Few Banks?

Concerns about the banking system have been top of mind in recent weeks.

Jamie Dimon — CEO of JPMorgan — released his annual letter to shareholders in early April, roughly three weeks after news of bank failures.

Referencing the issues, Dimon summarized his view, stating:

“Most of the risks were hiding in plain sight.”

The “risks” Dimon referenced were two-fold:

1. A rapid rise in interest rates damaged bank bond portfolios.
2. Large numbers of uninsured deposits sat alongside concentrated depositor bases — mostly venture capital-controlled companies — that ran in the same social circles and coordinated pulling deposits.

Put simply, the lights may have been on, but nobody was home in some banks risk management departments.

JPMorgan is the largest U.S. bank by asset size and Dimon played a key role holding the banking system together during the global financial crisis (GFC) — purchasing Bear Stearns and Washington Mutual — so his words carry a significant level of credibility.

Recently, First Republic — a top 20 U.S. bank by assets as recent as 60 days ago — essentially failed and was put into government receivership. Jamie Dimon and J.P. Morgan dusted off their GFC playbook and acquired First Republic from the government, and in effect, prevented its demise.

For those keeping score, we’ve now witnessed the second-, third-, and fourth-largest bank failures in U.S. history.


### Exhibit 1

<table>
<thead>
<tr>
<th>Bank</th>
<th>Year</th>
<th>Total Assets When Bank Failed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Washington Mutual</td>
<td>2008</td>
<td>$307bn</td>
</tr>
<tr>
<td>First Republic Bank</td>
<td>2023</td>
<td>$229bn</td>
</tr>
<tr>
<td>Silicon Valley Bank</td>
<td>2023</td>
<td>$209bn</td>
</tr>
<tr>
<td>Signature Bank</td>
<td>2023</td>
<td>$118bn</td>
</tr>
<tr>
<td>Continental Illinois</td>
<td>1984</td>
<td>$40bn</td>
</tr>
<tr>
<td>First Republic Bank Corporation</td>
<td>1988</td>
<td>$33bn</td>
</tr>
<tr>
<td>IndyMac</td>
<td>2008</td>
<td>$32bn</td>
</tr>
<tr>
<td>America Savings &amp; Loan</td>
<td>1988</td>
<td>$30bn</td>
</tr>
<tr>
<td>Colonial Bank</td>
<td>2009</td>
<td>$25bn</td>
</tr>
<tr>
<td>Bank of New England</td>
<td>1991</td>
<td>$22bn</td>
</tr>
</tbody>
</table>

Source: Morningstar

### Bank Failures

It’s felt like a rolling banking crisis of sorts. Silicon Valley Bank (SVB) and Signature Bank failed in March, Credit Suisse in Europe failed shortly after, and First Republic failed in April.

Excluding Credit Suisse, three U.S. banks with roughly $550 billion in deposits have failed. That’s significantly higher than the combined assets of the 511 banks that failed from 2009 through 2022. And it’s a record for a calendar year, surpassing the prior high in 2008.

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### Exhibit 2

#### Number of U.S. Bank Failures and Total Deposits of Failed Banks

(Since 2001)

- **Number of Bank Failures**
- **Deposits (Billions)**

Source: Morningstar, FDIC

It’s fair to ask, who’s next?
On a call outlining details of the First Republic acquisition, Dimon had this to say:

“No crystal ball is perfect. But I think the banking system is very stable. Tons of regional banks had great (earnings) results with very modest outflows. There are only so many banks that are offside (in the same way First Republic was). There may be another smaller one, but this pretty much resolves them all. **This part of the crisis is over.**”

While that statement guarantees nothing, it certainly paints a better picture. And it echoes what many banks said during earnings season, which was emphasizing signs of stabilization among depositors.

**Bank Earnings Recap**

Earnings season was an important hurdle for banks to clear. Results didn’t break any records, but they didn’t provide a reason to panic either.

Deposits were the key metric investors wanted to learn more about. Particularly, where are they staying and where are they going?

Apart from a few banks, deposits did not leave the banking system at a pace that warrants concern.

For context, deposits had been declining across the banking industry prior to March—they started falling last year as depositors took advantage of higher rates and moved “lazy” bank deposits into treasuries and money market funds.

**Exhibit 3**

![Quarterly Change in Deposits Graph]

Source: Morningstar, FDIC
Using data from Morningstar equity analyst Eric Compton, deposits were more volatile than other recent periods, but the contagion from SVB and others was not as bad as feared. First Republic’s deposit base shrank by 41% versus the fourth quarter—a massive decline—but no other large bank saw anything similar.

**Exhibit 4**

<table>
<thead>
<tr>
<th>Bank</th>
<th>(% Change vs. Prior Ctrl)</th>
</tr>
</thead>
<tbody>
<tr>
<td>JPMorgan</td>
<td>2%</td>
</tr>
<tr>
<td>KeyBank</td>
<td>1%</td>
</tr>
<tr>
<td>Trust</td>
<td>0%</td>
</tr>
<tr>
<td>Fifth Third</td>
<td>0%</td>
</tr>
<tr>
<td>Bank of America</td>
<td>-1%</td>
</tr>
<tr>
<td>Citi</td>
<td>-2%</td>
</tr>
<tr>
<td>Wells Fargo</td>
<td>-2%</td>
</tr>
<tr>
<td>Huntington Bank</td>
<td>-2%</td>
</tr>
<tr>
<td>Regions Bank</td>
<td>-2%</td>
</tr>
<tr>
<td>M&amp;T Bank</td>
<td>-3%</td>
</tr>
<tr>
<td>Zions Bank</td>
<td>-3%</td>
</tr>
<tr>
<td>PNC</td>
<td>-4%</td>
</tr>
<tr>
<td>Comerica</td>
<td>-9%</td>
</tr>
<tr>
<td>First Republic</td>
<td>-41%</td>
</tr>
</tbody>
</table>

Source: Morningstar Equity Research

Even Comerica, who saw a nine percent decline in deposits, made clear most of their deposit flight came immediately following SVB’s collapse and quickly corrected. In their words:

“We saw our peak impact in the days immediately following [SVB]. From there, outflows moderated and in the last two weeks of March, we saw a return to a more normal pattern, and that trend has continued [into April].”

Most banks repeated a similar narrative. While generalizing, there was an immediate reaction to SVB, but business trends reverted to a normal pattern a few weeks later.

**What Is the Market Telling Us?**

Banking issues immediately spur memories of 2008. But if we take our queues from the market, it seems to be telling us the “crisis” is mostly a nonevent.

The “fear index,” or the VIX, has mostly ignored it, hanging around its long-term average and well below prior peaks.
Exhibit 5

Stock Market Volatility
CBOE VIX Index


Since March 10 — the date SVB collapsed — the market has charted an upward course.

The Morningstar U.S. Market Index is positive, up more than 5%. While regional banks are in a bear market, down 24%, the financial sector is down less than 3%. Even more surprising, JPMorgan is up 7%, pacing ahead of the entire market — possibly indicating that some banks have been beneficiaries of this crisis.

Exhibit 6

Market Performance Since Silicon Valley Bank Collapse

The market has been very resilient, indicating—at least for now—the problem resides with a few banks rather than system as whole.

**More Regulations?**
One obvious outcome of this turmoil will likely be more regulation.

It’s worth pointing out many of the struggling banks were holding very safe government securities, and therefore, it’s unlikely any recent changes in regulatory requirements would have made a difference.

Unlike the GFC where toxic assets sparked a banking crisis, the spark this time was high-quality U.S. Treasuries underwater due to a rapid rise in interest rates.

As regulators debate new rules, the current economic backdrop will play a factor.

Consensus expectations are still calling for a mild recession later this year. Admittedly, gathering a consensus is difficult and “recession predicting” is often a futile exercise. But the Federal Reserve meeting minutes from March, showed the Fed was projecting “a mild recession starting later this year.”

If regulations come hard and fast, a credit slowdown (i.e., banks slowing lending) would be a likely outcome, potentially creating a more severe recession. For that reason, it’s more likely new regulations will be worked in slowly over time.

Promoting a healthy banking system will also be a top of mind. There’s a narrative that JPMorgan was able to scoop up a “trophy asset” in First Republic and benefitted from deposits moving from small banks to big banks.

Regulators don’t want a banking system with power concentrated in a few banks. A banking system comprised of very strong community and regional banks is what’s desired.

There’s a lot of moving parts that need accounting before putting in new regulations. But so far, the existing regulations are holding up. A few banks have gone under, and the rest of the banking industry appears to be operating well.

**The Bottom Line**
Most financial advisors practice diversification to help clients for the simple reason that it reduces concentration and doesn’t allow a single investment to ruin a long-term financial plan. A good banking system is built on a similar foundation—not allowing any single bank to have a profound impact on the rest of industry.

There remain a few banks that are struggling. It’s possible they could fail and more cracks emerge—you can never rule anything out with certainty. But it’s worth remembering that banks fail every year.
Despite some of the largest bank failures in history, the banking system continues to function well, and no depositors have been hurt. It will take time to sort it all out, but it will ultimately pass, lessons will be learned, and changes will follow.

The good news is this banking situation is distinct from 2008, because it has involved far fewer financial players and has fewer total issues that need resolutions.

The Grim Reaper in 2008 was toxic assets, specifically bad mortgages. No obvious Grim Reaper exists in 2023—the problems can basically be distilled down to poor management of high-quality U.S. Treasuries in the face of rising rates.

Fortunately, the market has a good track record of fleshing out bad news and reflecting it in market prices. To date, that’s mostly happened in a few banks, while the rest of the market has barely noticed.

Maybe it’s because everything was always hiding in plain sight.

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