

# The banking crisis and its effect on the markets, economy

David Hagee, Senior Vice President, Chief Investment Officer

**In light of recent market volatility,** Commerce Trust Chief Investment Officer David Hagee discusses the current disruption within the banking sector and addresses concerns Commerce Financial Advisors clients may have.

## How did we get here?

On Friday, March 10, California-based Silicon Valley Bank (SVB), with roughly \$200 billion in assets, was seized by regulators in the second largest bank failure in U.S., behind Washington Mutual's 2008 implosion, and the first closure since the Great Financial Crisis of 2007-09. SVB, which was heavily tied to the venture capital (VC) industry, lacked a highly diversified depositor base, leaving the bank vulnerable to large amounts of deposits being withdrawn at any single point.

Two days earlier, SVB sought to raise capital to reinforce its balance sheet due to mounting losses in the bank's investment portfolio, alarming investors and customers alike. Some VC clients began withdrawing funds from their accounts, starting a chain reaction that spread to other SVB customers. Within 48 hours, \$42 billion in deposits had been withdrawn from SVB accounts, leaving the bank insolvent and in receivership with the Federal Deposit Insurance Corporation (FDIC).

The run on SVB then rolled over to Signature Bank, a New York-based bank with a similar profile. Signature Bank's failure now ranks as the third largest in U.S. history.

Additional banks both inside and outside of the U.S. faced similar confidence challenges. First Republic Bank, a San Francisco-based regional bank struggling with cashflow issues, received a \$30 billion infusion from a group of America's largest banks. Meanwhile, Swiss-based UBS agreed to purchase its troubled rival Credit Suisse, which regulators hope stems additional panic at financial institutions in Europe and beyond.

This domino effect forced the Federal Reserve (Fed) to offer a credit facility to every FDIC-bank that holds a large portfolio currently trading at a loss, providing

these banks a lifeline to meet depositors' needs. The swift action by the Fed was designed to quell similar runs on other banks while providing liquidity to the marketplace.

When a bank fails, the FDIC insures deposit accounts with balances up to \$250,000 per depositor. Following the seizures of SVB and Signature Bank, the Biden administration announced accounts with balances greater than \$250,000 also would be covered by regulators.

## Are my assets with Commerce Financial Advisors safe?

Assets held in accounts at Commerce Financial Advisors are not part of the bank's balance sheet. Likewise, accounts administered at Commerce Financial Advisors are segregated from the bank's assets. We provide investment management, investment advice and other account management services to the account. In all cases ownership of these accounts remains vested in the individuals or entities and the assets are not subject to the claims of creditors.

**Commerce Bank ranks among the safest banks in the U.S.\***

The safety of brokerage accounts is not dependent upon whether the bank has assets greater than its liabilities. Property held in these accounts belongs to the owners of the accounts and would be unaffected by a bank failure.



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Assets held in deposit accounts become assets of the bank, creating a debtor-creator relationship between the bank and the depositor. In exchange for the money deposited, a liability of the bank is created which is the bank's contractual promise to repay the amount on deposit, plus interest, where applicable. Deposits are insured by the FDIC up to \$250,000 per depositor, per FDIC-insured bank, per ownership category

### How might this impact our clients' investment portfolios?

From the perspective of the financial markets, we continue to evaluate the fundamentals surrounding the markets and asset classes, specifically. We believe a diversified portfolio can help smooth returns when certain areas of the market are underperforming.

On the fixed income side of the ledger, we see these assets trading at a discount to their maturity value. We anticipate these debt instruments are likely to mature at their par value over time. Despite the possibility of trading at a loss in the short term, Commerce Financial Advisors believes it's important to continue to evaluate securities for the strength of the underlying companies, which in turn should drive repayment.

Meanwhile, we continue to anticipate churn in the equity markets. It's important to remember we've experienced a series of interest rate hikes at the fastest pace since the 1980s. We think it's likely that equities will be repriced on these higher interest rates. We also believe this is an opportunity for us to monetize this volatility, while maintaining overall diversified asset allocation, which has been shown over time to provide the greatest long-term return.

Because no investment is guaranteed, we encourage clients to discuss specific recommendations with their financial advisor.

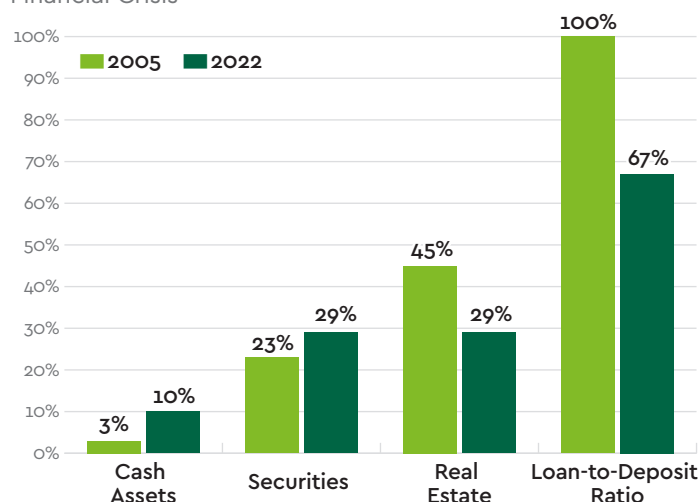
### Could this cause a ripple effect across the U.S. banking system?

While the current market situation is unsettling, the U.S. banking system remains structurally sound. Many reforms were instituted following the Great Financial Crisis to help buttress against possible bank failures. We anticipate investor sentiment toward financials

is likely to remain skittish in the short term. However, we believe in the overall strength of the sector over the long run. The U.S. banking system remains well regulated and capitalized, featuring numerous banks with highly diversified portfolios, strong liquidity positions and proven records of performance over time.

### BREAKDOWN OF U.S. COMMERCIAL BANK ASSETS

Bank portfolios much more diversified today than pre-Great Financial Crisis



Source: Goldman Sachs, FDIC, Commerce Trust

With regards to the Fed's ongoing efforts to tame persistent inflation, Commerce Financial Advisors expected the central bank to raise interest rates at its March meeting, even with the recent turmoil in the markets and financial services sector. This new 25-basis point increase marks the ninth straight time the Fed has raised the federal funds rate, bringing it to its current target range of 4.75-5.0%.

### The Federal Reserve's rate-hiking program could soon be ending.

We also believe the Fed could be near the end of its rate hiking strategy. It's likely we could see one more increase to the federal funds rate in 2023, depending on how the economy, financial conditions, and most importantly, inflation evolve over the rest of the year.



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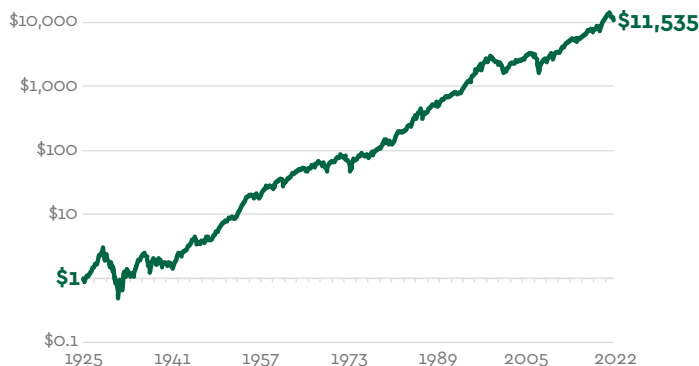
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## The need to remain disciplined

Commerce Financial Advisors believes staying focused on long-term financial or retirement goals requires the ability to navigate through all market cycles.

### VALUE OF \$1 INVESTED IN THE S&P 500 INDEX

(12/31/1925 – 12/31/2022)



Source: Ibbotson.

History has demonstrated that investing opportunities tend to reward patient investors. Since 1925, the S&P 500 Index has produced a 10.1% compound annual return. So, a hypothetical \$1 investment in stocks made in 1925

would have a value exceeding \$11,000 today — despite all the highs and lows the market has experienced over nearly 100 years.

The recent tumult experienced in the financial markets illustrates the importance of diversification. Yet, a diversified portfolio is just one step toward a long-term strategy of investing through all market conditions. Periodically rebalancing a portfolio during extended periods of market stress also can present buying opportunities. In addition, taking the steps to de-risk a portfolio during downturns may reduce exposure to more volatile asset classes.

*We recognize peace of mind can be a scarce commodity during uncertain times. The team at Commerce Financial Advisors is available to help clients remain focused on their long-term goals through the periods of uneasiness that can arise during market cycles.*

*Contact us today.*

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## David Hagee

Senior Vice President, Chief Investment Officer

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David is the chief investment officer for Commerce Trust and Commerce Investment Advisors, Inc., the SEC-registered advisor to the Commerce Funds mutual fund complex. David has been with Commerce Bank for 23 years, during which he worked as a portfolio manager with private and institutional clients before becoming the director of portfolio management for the eastern region. David earned his Bachelor of Arts from Washington University in St. Louis. Additionally, he is a member of the CFA Institute and the St. Louis Society of Financial Analysts as well as a board member and Treasurer of Aim High St Louis. He serves as the President of the Investment Committee of the Center of Creative Arts (COCA) and serves on the investment committee of Forest Park Forever and the International Institute.



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