

Where Are We Post “Intervention”?

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Normally Mondays are easy here at the T-Report. We usually just send out Sunday’s piece for those who didn’t read it. Well, we sent out a [much longer one than usual on Saturday night about SIVB](#), and just like [Friday’s quick blurb](#), it already needs to be updated and massaged to adapt to the new circumstances post “intervention”.

The intervention came last night just as futures opened. The depositors at Silicon Valley Bank (and Signature Bank) should be able to carry on as normal, but not so much for the debtholders, the equity holders, or presumably the management teams.

Banks, across the board, will be able to borrow from the “window” and get “par” credit for bonds that no longer trade near par.

S&P futures soared as high as 3,971 (up 75 points) and are basically unchanged as I type this.

Treasuries have also been all over the place, with the 2-year going as low as 4.15% (now 4.3%). While the 10-year initially traded a smidge higher in yield, it got to as low as 3.49% (crazy!) and is back to 3.55%.

The single biggest theme out there, across markets, is **unrealized losses on bond positions**.

Everything is Connected to “Unrealized Losses on Bond Positions”

We can get into the nuances of everything that is going on, but at the heart of the matter is concern around the size of bond portfolio losses sitting on books (of banks in particular, but more broadly as well).

Unlike the GFC, it isn’t hard to value these holdings because in most cases it is the high credit quality/highly liquid bonds that are in question. Sovereign debt is also of concern (Europe started turning stock markets lower as the gravity and scale of unrealized bond losses overwhelmed any other market sentiment). Mortgages, agency, and otherwise are next in line behind sovereign debt because people are questioning the “quality” of balance sheets. People are not questioning the credit quality, but the current market value of those bonds due to interest rate risks.

What About the “Intervention”?

I see a few things worth commenting on:

- **It was typical for markets to fade the big initial reactions to “interventions” during the GFC and the European Debt Crisis.** So, some of this fade is “normal”. Whether we bounce back will be a function of how the market digests several things.
- **The intervention itself had some good and bad “features”:**
 - **It was good that the response was quick and aggressive.** We will highlight what may have been missed by the response, but it is important to note that this “**first**” cut was aggressive. I highlight “first” since given the aggressive and timely nature of the response, if it doesn’t work, we should expect more!
 - **It was bad, in my opinion, because it didn’t have a “private” solution for SVB.** I am not sure what happened to the bids that they were collecting on Sunday afternoon. I heard various smart estimates of high recovery values even from someone buying the assets **without giving much value to an “ongoing concern” analysis.** I suspect that it was a nod

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to politicians that the press release had to state that debt and equity holders would be “punished” (ok, it didn’t say punished, but that was the connotation). **Including “politically necessary statements” along with saving the banks sends a mixed message. No wonder people were selling bank stocks all night in Europe and once pre-market trading opened in the U.S.** I think that a “backstop” of sufficient scope to let companies carry on their ordinary course of business (while figuring out if a buyer could be found that would pay to keep the SVB ongoing business intact) made sense. **Weird mixed messages were sent which certainly spooked equity and debt holders in the banks that were the next most likely institutions to have trouble.**

- **It was weak because addressing funding doesn’t address the holes in the balance sheet.** Funding helps. It helps those in urgent need, but the rest of the cheap funding helps over time and only if enough has been done to avert the crisis. The early “cheap” funding of mortgage-backed products in 2007/2008 failed because it didn’t stop the declines in housing prices. Similarly, LTRO, a European concoction allowing banks to cheaply fund sovereign debt positions for term, took time to kick in. Cheap lending (getting par treatment on bonds not trading at par) seems to fit some definition of cheap and isn’t a bad thing per se, but it just isn’t sufficient. **Capital is the only thing that truly fills balance sheet holes.**

Some of the reaction is normal and is based on the fact that the “intervention” is far from perfect, but it also risks missing that the Treasury/Fed/FDIC are far from done or out of tools!

The Fed’s Prime Directive

I am sure that I am going against all sorts of legal documents, but while the Fed has the dual mandate of employment and inflation, they have a prime directive that overrides everything else – **DON’T LET BANK RUNS HAPPEN!**

I’m not sure how they hike rates when the biggest issue out there is unrealized losses on bond portfolios (which aren’t helped by increasing the cost of carrying those losing positions).

I doubt that they are sitting at home this morning congratulating themselves. I am willing to bet (and am betting) that **Sunday was just a first salvo.** It was a bazooka, but they have more ammo and should buy themselves some time. It will also give banks themselves time to address the concerns of their depositors, creditors, and shareholders.

Do The “Powers that Be” Understand the Internet?

One thing that I am concerned about is how big of a role social media plays in the speed in which these bank runs happen.

The intensity of bearish and fear mongering posts is real. **If social media can affect elections and Covid views, why can’t it influence bank runs?**

Banks, the Fed, Treasury, and the FDIC have to understand that the battle is being fought as much (or more) on Twitter and TikTok as it is in the financial media!

I have my doubts that they understand this and that concerns me.

Bottom Line

Buy dips on bank fears – more support to come and time will help.

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Sell rips because the debt ceiling debate, already likely to be ugly, will get uglier. With Xi supposedly heading to Russia, there is a chance that this indicates peace, but I’m leaning towards weapons sales. However, the West just really doesn’t believe that China, which wants to remain a vibrant part of the Western economies, will do this.

Finally, ODTE options aren’t going to make this any easier as they will amplify moves in both directions, and I am concerned that they have the potential to trigger a much bigger meltdown than melt up here!

Good luck in these crazy times! Seriously, who had bank bailout on their 2023 bingo cards?

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