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INSIGHTS & OBSERVATIONS

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YOUR GUIDE TO FINANCIAL MARKETS AND INVESTMENTS **April 2023**

Welcome back. Last month in the space of only a few nervous days we watched four relatively large banks get into trouble and require financial support. Three were US, based in California, and the other was the second largest Swiss bank.

The US institutions shared common risks notably including a focus on venture capital clients and crypto currency business relationships. Credit Swiss had different problems which had been ongoing for years.

However the common thread and root cause of their demise is higher interest rates. As Warren Buffett says, *"Only when the tide goes out do you learn who's been swimming naked."*

In late March, we learned these banks had not managed their exposure to higher interest rates properly, and it destroyed them. Two of the three US banks were large enough that government felt the need to intervene, prompting speculation about a system-wide problem and additional federal rules around deposit insurance limits and other concerns. For now things have settled down but it is far too early to sound the all clear.

Virtually every time interest rates have a cyclical rise they do so until 'something breaks' at which point rates usually flatten out, and sometimes head back down. This past cycle has been the fastest boost to rates in decades, and is occurring in a vastly more indebted world. So I expect more things to break in the medium term, hence our recent uncertain outlook on interest rates.

Canadian banks remain much more conservatively positioned and our regulatory structure denies them the ability to take the type of risks the now failed US banks did, however I do worry about Canadian's record personal debt and observe our banks thinking the same way.

A recession and ongoing real estate pullback certainly would slow our bank earnings for at least a few quarters, however they seem to already be braced for this possible outcome.

Thinking about the longer term big picture, in this month's feature article we get much further into debt and interest rate cycles, and it is well worth the read.

Overall I continue to expect our market to be stronger than most even through any pullbacks, and we are carefully optimistic about many trends in which we've invested. The stresses caused by rising rates are not a surprise, and suddenly once again we've got lots going on in the world!

Have a great month and take care.

Philip

April's Articles

Ray Dalio is a famous US hedge fund manager who's become somewhat of an economic philosopher in recent years. With his enormous investment management company behind him, the research and perspective of his writing is extremely impressive.

In the article linked below he revisits interest rate cycles and their affects on markets and the economy. The latest US bank failures prompted him to comment on those troubles and more importantly, how they fit into his models at various stages of the economic/debt cycle.

I will note his thoughts are for US markets and their economy, and as mentioned on page one our banking system is more conservative. In recent years our stock market has also done better than most others including the US, which is as expected when interest rates and inflation are climbing.

That said, all investors need to learn and remember the lessons of history, as enough of it repeats to be quite useful in the present. Today the size of government debt worldwide will absolutely have consequences and create bad outcomes. Further the political decisions on this and other topics seem to be worsening, which can only further amplify the risks especially as interest rates rise.

We are fortunate to have a far more stable bank system here in Canada, however we also must pay close attention to the bigger picture which always influences our markets and economy.

How quickly things have changed from one year ago, and we expect to see much more change in the next while.

https://www.linkedin.com/pulse/what-i-think-silicon-valley-bank-situation-ray-dalio/

Continuing our focus on the banking sector, in the article linked below we find another view from US strategist **Brian Wesbury** of First Trust.

His concern addresses the longer term trend of governments 'bailing out' banks and their errors over time. Again we are not seeing this occur here in Canada, however most other large countries have used taxpayer money to rescue banks who get in trouble, usually from their own mistakes.

Certainly the Swiss and US bank problems last month fall into this category, and various other rescues were made during the Financial Crisis of 2008-9. We've also watched government and Central Bankers change rules and laws on the fly during stressful periods, usually at the expense of taxpayers.

As the article shows however, over time these changes continue to encourage poor risk-taking decisions by big banks who now know the government will bail them out if things go south. The longer this reality exists, the greater the size and degree of problems it will create. Finally none of this matches the original design of a banking system which served us very well since World War II, and now appears to be weakened by all this 'help.'

https://www.ftportfolios.com/blogs/EconBlog/2023/3/20/heading-toward-a-national-bank

What They Said

"If you owe the bank $100 that's your problem. If you owe the bank $100 million, that's the bank's problem."

J. Paul Getty