CIM Market Update | FDIC & Fed Action

March 2023

We wanted to share our market insights and outlook in light of the extraordinary events of the past few days. The failure and closure of the three US banks, including Silicon Valley Bank (SVB), the second largest bank failure in US history, has weighed heavily on the minds and emotions of investors. This is evident in the flight to quality and market reaction we are witnessing. The FDIC, together with the Federal Reserve and the Treasury Department, acted quickly to ringfence the potential contagion of these bank failures by ensuring that, despite bank closures, depositors will have access to 100% of their deposits held at the failed banks. They also indicated that depositors at any future banks that may fail, would also be protected. In addition, the Fed established a new Bank Term Funding Program (BTFP) which will provide financing to banks, at 100% of face value of US Government, Held To Maturity (HTM) assets, even if they have decreased in value due to the recent rise in interest rates. The BTFP was established to stave off future bank failures. Banks will now have access to liquidity should they need it, which should provide further confidence to depositors.

While these are very positive steps and should limit the systemic risk of further contagion and diminish the probability of a dramatic increase in bank failures, these actions do not diminish the reality that materially tighter lending standards and credit conditions will likely occur as a result. This will negatively impact bank and corporate earnings potential for an extended period in our view. We, at Clinton Investment Management (CIM), have been advising investors, for a number of months, that an increasing risk of an impending economic slowdown exists due to the most aggressive Fed tightening cycle in roughly 40 years. We have been encouraging investors to prepare for meaningfully slower growth that will likely result in significantly lower inflation over time as a result. We also believe the Fed hiking cycle is almost complete and that peak interest rates have likely been seen. Recent events reinforce this view and provide further support to the notion that the Fed will be forced to cut interest rates as economic growth contracts in the not-too-distant future. In preparation for this expected reality, we are encouraging investors to act deliberately and expeditiously to take advantage of the relatively high level of tax-free yields that are currently available in longer duration municipal bonds, as we do not believe the current level of interest rates will persist for very long. We believe the high quality and stability of the underlying credits will provide safety as market uncertainty persists.

We would invite anyone with questions or concerns to reach out to us as we go forward. We are happy to provide any insight we can.

Best Regards,

Andrew Clinton

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