A new banking crisis ?

No replay of the financial crisis - but aftershocks to be expected

Dr. Michael Heise on Global Economics

March 2023

Will the financial stress triggered by the collapse of Silicon Valley Bank remain temporary and limited - or will the situation come to a head and become a systemic crisis? Even days after the collapse of Silicon Valley Bank (SVB) in the U.S., there is no consensus among financial market experts as to whether the turbulence it has triggered on the global financial markets will soon end or whether it could grow into a systemic crisis.

1. Psychology and confidence play a big role in banking crises

Even days after the collapse of Silicon Valley Bank (SVB) in the U.S., there is no consensus among financial market experts as to whether the turbulence it has triggered on the global financial markets will soon end or whether it could grow into a systemic crisis.

Typically, in banking crises one first looks to the facts that might suggest a limited problem. SVB was relatively small compared to the major U.S. banks, so it was not subject to the particularly rigorous supervision that larger systemic banks are, and it had a special clientele with many firms in the startup scene that had to reduce their deposits quite significantly during the recent difficult times. From this perspective, the development could be seen as a limited collateral damage of the hefty interest rate hikes and the inverse interest rate structure of the past months. As the Federal Reserve has created new credit lines and the Federal Deposit Insurance is guaranteeing the deposits, one would conclude that further contagion effects will not materialize.

The problem with predicting banking crises, however, is that psychology and trust play a critical role next to all complex financial interactions and are notoriously difficult to predict. Households and companies that hold large unsecured deposits with banks will naturally ask themselves how safe these deposits are. If there are any doubts, deposits will be shifted, for example from smaller regional banks to larger institutions that are not only more intensively supervised but also under a presumed government protection umbrella (too big to fail), or they will be shifted into short-term securities or cash.

Whether such a process takes place, which could put large parts of the banking system in trouble, depends in turn on the credibility of the pledges made by central banks and deposit insurance funds to protect deposits. In the case of the SVB, this assurance could be given, but if more and more banks were affected by a withdrawal of deposits, the deposit insurance funds, which are financed by the banks themselves, would no longer be sufficient to provide full protection. In the case of widespread mistrust in the safety of deposits it is only

Marketing document for discussion purposes and for information only. For further information see disclaimer.
Date of publication: 29.03.2023 09:00

the governments and the taxpayers behind them that can cut through a negative spiral of deposit withdrawals and liquidity shortages in the banking system. The promise made during the financial crisis in 2008 by former Chancellor Merkel and then Finance Minister Steinbrück that all deposits would be safe is the most prominent example of such a government rescue promise.

2. Does it have to end that way again?

There are a number of arguments against it. First, there is a market corrective in the form of falling interest rates and interest rate expectations. For example, in the days after the SVB collapse and again after the Credit Suisse problems, we saw yields on government bonds fall, i.e. valuations of these securities rise. This reduces losses when banks sell government bonds to create additional liquidity. Together with the commitment of the U.S. Federal Reserve to accept government bonds at par as collateral for credit lines, this should have a calming effect.

With regard to interest rate policy, however, the central banks are in a dilemma. After all, in view of stubbornly high inflation, they would have to raise interest rates further, which also tends to increase capital market yields and entails valuation losses. Refraining from further rate hikes to prevent a banking crisis will tend to raise inflation expectations and create longer-term problems. The ECB has decided to raise interest rates despite the market turmoil. Due to this difficult situation, increased volatility is to be expected in the coming weeks.

Of particular importance in this situation are the potential liquidity commitments of central banks, such as those made by the U.S. Federal Reserve and the Swiss SNB. Through these programs, the still very high central bank reserves of the commercial banks - in the European Monetary Union they are about 4 trillion euros, in the U.S. about $3 trillion - can be expanded if necessary. This should remove the basis for a negative fear psychology. However, depending on the collateral securities, such loans also increase the risk for the taxpayer. And they will also put an end to the central banks attempts to reduce their bloated balance sheets. Quantitative tightening will have to be postponed for some time.

3. What lessons could investors learn from the crisis?

First of all, it is once again apparent that banking risks are difficult to predict, even for central banks and rating agencies. The sharp increases in key interest rates by central banks, which initially gave a tailwind to the share prices of many banks, create a problem for banks when depositors withdraw money and long-term, low-interest government bonds have to be sold at a loss because other credit lines are not available.

The possibility that further banks could be negatively affected by these developments can by no means be ruled out. After all, it is a core business of banks to invest short deposits on a long-term basis. This so-called maturity transformation is certainly desirable from an economic point of view, but it generates considerable risks in the event of inverse interest rate structures and sudden withdrawal of deposits, as has been shown time and again in previous financial market crises: It comes down to good management of classic interest rate risks.

4. Conclusion

From all this, it follows that investors should prefer a very cautious positioning in the financial sector. Banks' margins are likely to be under pressure as a result of recent events, because competition for deposits has become fiercer. Also, bondholders and shareholders of troubled banks are deliberately not protected by the measures taken so far. In this respect, the time for buying bank shares has probably not yet come, despite considerable valuation setbacks. The phase of volatility is likely to continue also on the stock market as a whole. Potentially, market gains could be triggered by the central banks fundamentally correcting their restrictive anti-inflation policy and, for example, indicating interest rate cuts. However, this bet is not to be recommended. Central banks will not compromise their commitment to price stability. If this were also cast into doubt, the next crises would be in the making.

Marketing document for discussion purposes and for information only. For further information see disclaimer.
Date of publication: 29.03.2023 09:00

Notes on investment strategy - Investment recommendation pursuant to § 85 of the German Securities Trading Act (WpHG) in conjunction with the German Securities Trading Act (WpHG). Regulation (EU) No. 596/2014

General
The investment strategy and/or investment recommendations (hereinafter referred to as "analyses") are prepared by LeanVal Research GmbH for information purposes only.

Neither LeanVal Research GmbH nor its employees accept any liability for damages arising from the use of the analyses or their content or in any other way in connection with them. The analyses do not constitute an offer or invitation to subscribe to or purchase any security, nor do they or the information contained therein form the basis for any contractual or other obligation of any kind. An investment decision should be made on the basis of a duly approved prospectus or information memorandum and in no case on the basis of the analyses. Investors should seek the advice of an investment adviser in making their investment decision. In this respect, the analyses cannot assume an advisory function. The opinions, estimates and forecasts contained in the analyses are solely those of the respective authors. They are date-related, not necessarily the opinion of LeanVal Research GmbH and may change at any time without prior notice.

The information and assessments ("Information") reproduced here are primarily intended for clients of LeanVal Research GmbH in Germany. Should the original recipient forward the analysis, he/she is obliged to do so in compliance with existing regulations and laws and this does not result in any obligation of LeanVal Research GmbH towards a third party. In particular, the information is not intended for clients or other persons domiciled or resident in the United Kingdom, the United States or Canada and may not be passed on to such persons or imported into or distributed in these countries. Distribution of the analyses in other jurisdictions may be restricted by law and persons into whose possession the analyses come should inform themselves about and comply with any restrictions. Any failure to comply with these restrictions may constitute a violation of applicable securities laws. Reprinting, redistribution and publication of the analyses and their contents in whole or in part is only permitted with the prior written consent of LeanVal Research GmbH.

Sources of information
All analyses are prepared on the basis of data from a data provider and from generally accessible sources ("information") that LeanVal Research GmbH considers to be reliable. However, LeanVal Research GmbH has not checked the Information for accuracy or completeness and assumes no liability for the accuracy and completeness of the Information. Any incomplete or incorrect information does not constitute any liability on the part of LeanVal Research GmbH for damages of any kind whatsoever, and LeanVal Research GmbH is not liable for indirect and/or direct damages and/or consequential damages. In particular, LeanVal Research GmbH accepts no liability for statements, plans or other details contained in these analyses with regard to the companies investigated. Although the analyses are compiled with all due care, errors or incompleteness cannot be ruled out. LeanVal Research GmbH, its shareholders, corporate bodies and employees accept no liability for the accuracy or completeness of the statements, assessments, recommendations derived from the information contained in the analyses. Data source for all historical prices is Morningstar and LeanVal Research.

Summary of the valuation fundamentals
The valuations underlying the investment recommendations for stocks analysed by LeanVal Research GmbH are based on generally accepted and widely used methods of fundamental analysis, such as the DCF model, peer group comparisons, NAV valuations and - where possible - a sum-of-the-parts model. The calculated scores (Value, Quality, Stability, Growth) are the result of a proprietary model of LeanVal Research GmbH. They result from the comparison of fundamental key figures of the quantitatively analysed company in relation to comparable companies within a sector (or region). Information on the general approach can be found at www.leanval.investments. The absolute target price and the associated absolute assessment (undervalued, neutrally overvalued) are determined using a DCF or ROIC (Return on Invested Capital) method. Estimates of future profits serve as the basis for this. The earnings estimates are either based on a consensus or are made by LeanVal Research GmbH itself.

Updates
The recipients are not entitled to the publication of updated analyses. LeanVal Research GmbH reserves the right to update analyses without prior notice. Regular updating of this document is not planned.

Compliance
LeanVal Research GmbH has taken internal organisational and regulatory precautions in implementation of the statutory and supervisory regulations in order to avoid conflicts of interest in the preparation and dissemination of financial analyses. In particular, there are internal information barriers that prevent analysts from accessing insider information. Compliance is monitored by the Compliance Officer.

Explanation of the recommendation system
The relative assessment is based on the various scores of the individual companies in the areas of Value, Quality, Stability, Growth and Momentum, which are compared with the average values of the overall market and/or the respective sectors. The companies are ranked on a scale from 0 to 100. From this, the three ratings "unattractive" (0 to 30 on the scale), "neutral" (31 to 70 on the scale) and "attractive" (71 to 100 on the scale) are derived. The relative assessment can change at short notice due to the high complexity of the scores and the multiple interdependencies between the analysed companies.

The rating system of LeanVal Research GmbH for absolute valuation includes the ratings "undervalued", "fairly valued" and "overvalued". The rating of a share is based on the expected return for the next six to twelve months. The expected return is made up of the projected change in the share price and the expected dividend yield. Changes in the discount factor or projected cash flows can lead to significant changes in the target price.

Absolute valuation rating system:	
Buy	Potential > +15%
Hold	Low upside and downside potential
Sell	Potential < - 15%

Conflicts of interest

In the financial analyses, circumstances or relationships that could give rise to conflicts of interest because they could jeopardise the impartiality - of the employees of LeanVal Research GmbH who prepared the analysis, - of LeanVal Research GmbH as the company responsible for the preparation or of companies affiliated with it, or - of other persons or companies working for LeanVal Research GmbH and contributing to the preparation, must be disclosed. Information on interests or conflicts of interest which must be disclosed shall exist in particular if

1. significant shareholdings (= shareholding > 5 % of the share capital) exist between the above-mentioned persons or companies and the issuers who are themselves or whose financial instruments are the subject of the financial analysis,

2. the above-mentioned persons or companies manage financial instruments, which themselves or their issuers are the subject of the financial analysis, on a market by placing buy or sell orders (market making/designated sponsoring),

3. the above-mentioned persons or companies have been involved in the management of a syndicate for an issue by way of a public offering of such financial instruments which are themselves or the issuers of which are the subject of the financial analysis within the preceding twelve months,

4. the aforementioned persons or undertakings have, within the preceding twelve months, been bound by an agreement for services in connection with investment banking transactions vis-à-vis issuers which are themselves or whose financial instruments are the subject of the financial analysis, or have received a performance or a promise of performance under such an agreement during this period, insofar as no confidential business information is affected by the disclosure of this information,

5. the above-mentioned persons or companies have entered into an agreement with issuers, who themselves or whose financial instruments are the subject of the financial analysis, for the preparation of the financial analysis,

6. the above-mentioned persons hold management or supervisory board mandates with issuers whose financial instruments are the subject of the financial analysis, or

7. the aforementioned persons or companies have other significant financial interests in relation to the issuers whose financial instruments are the subject of the financial analysis.

LeanVal Research GmbH
Bleichstraße 52

60313 Frankfurt am Main
Telefon: +49 69 9494 88 050
E-Mail: research@leanval.investments