



Hutchinson Financial Advisors, Inc.
5243 Hickory Park Drive, Suite C
Glen Allen, VA 23059

Main: 804.729.6420
Fax: 804.729.6425

HutchinsonAdvisors.com

1st Quarter Special Update

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“Only when the tide goes out do you discover who’s been swimming naked.” -Warren Buffett

Happy end of winter, though technically we still have a few more days until the official start of Spring. I’ve had many calls and emails asking about the banking system. Sadly, I’ve also seen too many people giving out misinformation for political purposes. Thus, I thought I’d share some brief thoughts on the situation. I will save more details for when I address this in my quarter-end letter, which should be out by month-end.

As you know by now, two U.S. banks failed within the last week. Those bank failures have caused some consternation in financial markets. One bank failure was Signature Bank of New York (SBNY). Along with Silvergate Bank, which is also being liquidated, SBNY was a major source of funding for crypto companies. Given the destruction in the cryptocurrency space over the last year or so, their demise was not really a surprise to many in the industry.

The other bank failure last week did raise some eyebrows, and that was the failure of Silicon Valley Bank (SVB), part of SVB Financial Group (SIVB). At the time of its closing on March 10, SVB was the 18th largest bank in the U.S. It is now the 2nd largest bank failure in history. As a result of this bank failure, naturally the eyes turn toward other banks to see who may be in trouble. A couple of regional banks are rumored to have some problems. While nothing seems imminent now, things move rapidly in this space. Regardless, the entire banking industry is under the microscope and the stocks of most financial companies have been hammered.

While I could certainly be wrong, I do not believe this is a systemic problem now. Silvergate and Signature did most of their business in the crypto space, and SVB catered to tech start-ups and venture capital companies. The overwhelming majority of banks have a much wider base of clients, both retail and corporate than these three did. Also, it should be pointed out that Signature’s management failed to properly manage their balance sheet. In other words, they didn’t match up their assets and liabilities properly, taking too much interest rate risk, and that is what caused the failure of the bank once the run started last week.

As you know, I try to keep away from politics for a variety of reasons. However, I must make an exception because I’ve heard some things from both sides that aren’t necessarily accurate, and they’ve been mentioned purely for political reasons. For example, I’ve heard that it was the rollback of regulations in 2018 that caused the problem. The rollback of regulations in 2018 simply reduced some regulatory burden for banks with less than \$250 billion in assets. It did NOT eliminate regulations for those banks, so the idea that the rollback caused this problem is disingenuous at best. According to the FDIC, there are over 4,000 FDIC-insured banks in the U.S. All but ten have less

than \$250 billion in assets, so over 4,000 are operating under the same regulatory structure as the banks that failed. If just three of the four thousand fail, then a reasonable person would conclude that it isn't the reduction of regulatory burdens on banks under a certain size that was the source of the problem.

Separately, I've heard and seen others suggest the problem is that banks are led by people who focus on DEI (diversity, equity, and inclusion). Most publicly traded companies in the U.S. have DEI policies, so that reason is disingenuous at best, too. Also, in looking at the executive teams of the three failed banks, you'll see that leadership roles at all three were filled by people with loads of experience in the banking and financial service industries.

Lastly, I have seen people suggesting that the action by the Federal Reserve and the FDIC to protect depositor's money above the \$250,000 FDIC threshold was a bailout of the banks. As of this writing, the equity holders of all three banks are being wiped out and management is being fired. These three banks will cease to exist. In my opinion, that doesn't sound like a bailout of the banks.

As mentioned on page one, I'll dig into things in more detail in my quarter-end letter. One of the things I'll discuss is the importance of Fed policy and interest rates as it relates to what happened. I'll also touch on how the internet has changed banking, and the role it may have played in the bank run on SVB. If there is something else you'd like me to cover, then please feel free to let us know.

Bottom line: there is no need to panic. Please just be aware of FDIC limits on bank deposits and feel free to contact me with any questions.

I hope you and yours are healthy and enjoying a wonderful start to the new year. Please let us know if there is anything we can do for you. We're always here to help. From all of us at HFA, thank you for your trust, confidence, and loyalty. It is a joy and a privilege to work with you and your family.

Best wishes,

Harvey E. Hutchinson IV
Harvey E. Hutchinson IV
President

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