

INVESTMENT STRATEGY

April 1, 2023

Well, it feels like déjà vu all over again in the world of banking and finance. The use of the word *world* is intentional as the interrelation of banks is not local but rather global. So the Silicon Valley Bank sneezes, and the global banking system catches a cold. Not to be outdone by the absolutely negligent mismanagement by SVB of its dislocation/mismatch of assets and liabilities, the Securities Bank on the other side of the country somehow thought it was appropriate to provide banking services to cryptocurrency exchanges (more on this later). It's hard to imagine what could go wrong with that. In any event, this appeared to be a thoroughbred stakes race between stupidity and greed; my interpretation intuitively it was pretty much a dead heat photo finish.

All of these gyrations have now put the Fed in an even more difficult place as they sit between a rock and a hard place. The rock in this metaphor is the increasingly stubborn fight against inflation, necessitating an accelerated rise in interest rates after living on this synthetic rate bottom (near zero percent rates) for nearly a decade. The hard place, now rearing its scary head, is the need to maintain stability among the global banking system and not create a further detachment between banks carrying long-term Treasury notes at below market rates while they are having to increasingly compete for short-term deposits through the incentive of higher rates. Clearly, it's an example of the more you bet, the more you lose or, put another way, it's a losing proposition but you can make up for it with volume.

All of this means I think you will see a migration of customer deposits flowing from smaller to larger banks. While this may be good for the nerves, it's probably not great for a competitive banking landscape over the longer term. This said, though once the dust (and the nerves) settles I think the banking system is generally in relatively stable/strong shape as the capitalization across the spectrum (especially with the larger banks) appears much more sound and stable than in prior crises such as the savings and loan and the subprime mortgage debacle. Overall, I think the banking patient is in relatively good short and longer-term health (although, it did occur to me that Senator Elizabeth Warren's head might explode while she was holding hearings on SVB and the Signature Bank failures).

It probably makes sense to touch upon asset safety during periods of banking/financial stress. We have done extensive due diligence on Charles Schwab & Co. as a "best of breed" safekeeping custodian for client assets. We consider them the largest and safest custodian of assets, especially for the professional money manager community. Schwab also has deep

technology and cybersecurity capabilities. All client securities are fully segregated and are not exposed to comingled use by Schwab or anyone else. In my opinion, client assets are totally protected and safe. Please see the following link:
<https://www.aboutschwab.com/perspective-on-recent-industry-events>

One thing I learned during this quarter is that the intersection of malice and avarice is a dangerous place. Here again, I return to the world of cryptocurrency and the failure of the various exchanges that purported to maintain an orderly market for currency that you can apparently make up in your basement. Sam Bankman-Fried looks like he was sent from central casting for the role. Look at SBF's \$250 million bail, and I think *really*? Apparently, within the world of crypto exchanges it is okay for them to use your money as they see fit. Or, put another way, once you give it to them, apparently it is not *your* money anymore. In any event, this circle of malice and avarice remains unbroken. A final note, I noticed that when SBF went posting this ginormous bail, they kind of insisted that it be posted in dollars and not bitcoin.

I remain amazed at how bad business decisions reflect that not only are people willing to sell their soul, but it's amazing how cheaply they will do it. Looking at the Silicon Valley Bank, the disconnect between reason and a short-term pickup of a few basis points of spread is really hard to fathom. The conclusion, it's tough to bet when the outcome depends on perfection.

Taking our usual walk about and roundup of current market action, I am really surprised at how amazingly resilient and calm the United States equity markets have been in a storm. Although interim volatility is heightened for sure, the overall net result in price action has not been nearly as dramatic as I feared. As I write this, most of the major indexes are within three to five percent (either way) of being even for the quarter. To which I would note the following:

1. During difficult times, there is a consistent theme of a flight to quality, whether it be in equities or fixed income. To this point, you can witness the sharp flow of funds into United States Treasury securities, driving return lower in spite of the Fed's recent rate increases. This probably reflects the Fed's grudging pause for a while as banking nerves settle down.

The flight to quality finds its way into the equity markets, as well. This suits us fine, as our consistent philosophic theme has been to own quality and predictive (and hopefully sequentially increasing) cash flow. To this point, technology has been a scarce high point during the first quarter of the year, bouncing back from a very difficult 2022 when the Nasdaq was down about thirty percent. In our

world, **Microsoft** and **Apple** have been relatively strong performers and, more importantly, give us heart for their longer-term prospects.

2. Utilities. Again, during times of stress (both psychological and financial), the relatively boring foxhole of utilities offers some comfort. **Southern Company** and **Duke Energy**. Although people may be worried to death, they still pay the light bill.
3. Industrials and the Economic Landscape. This part of the world seems a little bit more worrisome. High quality players in this space that I love, such as **Caterpillar** and **Deere**, have been somewhat weaker during the quarter as the market anticipates an economic slowdown. Commercial real estate looks to be slowing dramatically, and as a result the need for industrial equipment may be softening just a touch. This said, I continue to think the space has promising long-term legs into the future.

So, in sum, I feel as though we are weathering the current landscape in relatively good shape, largely preserving capital since the bear market began five quarters ago. Once again, I characterize the overall personality of our equity portfolios as relatively resilient, but certainly not immune, to stock market pressures. It resonates with the delicate balance of safety and return. I am reminded of the following joke about platonic love: *you can be friends with your dog and friends with a bottle of whiskey, but you try to be friends with a woman, you end up drunk kissing your dog.*

In closing, I always find comfort in both the literal and metaphorical renewal of Spring. It is a great time of the year here in Northeast Florida. And like my beloved Cubs and my fascination with the markets, in Spring hope springs eternal. We hope this finds you and family healthy and well. As ever, we remain keenly appreciative of your treasured trust and the opportunity to work on your behalf.



Charles D. Hyman

Note: Please know we are always available to discuss your portfolio and any of the issues that may be taking place within the fabric of your life that would influence our strategic design, your liquidity needs/reserves, or really anything else orbiting the life financial.

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