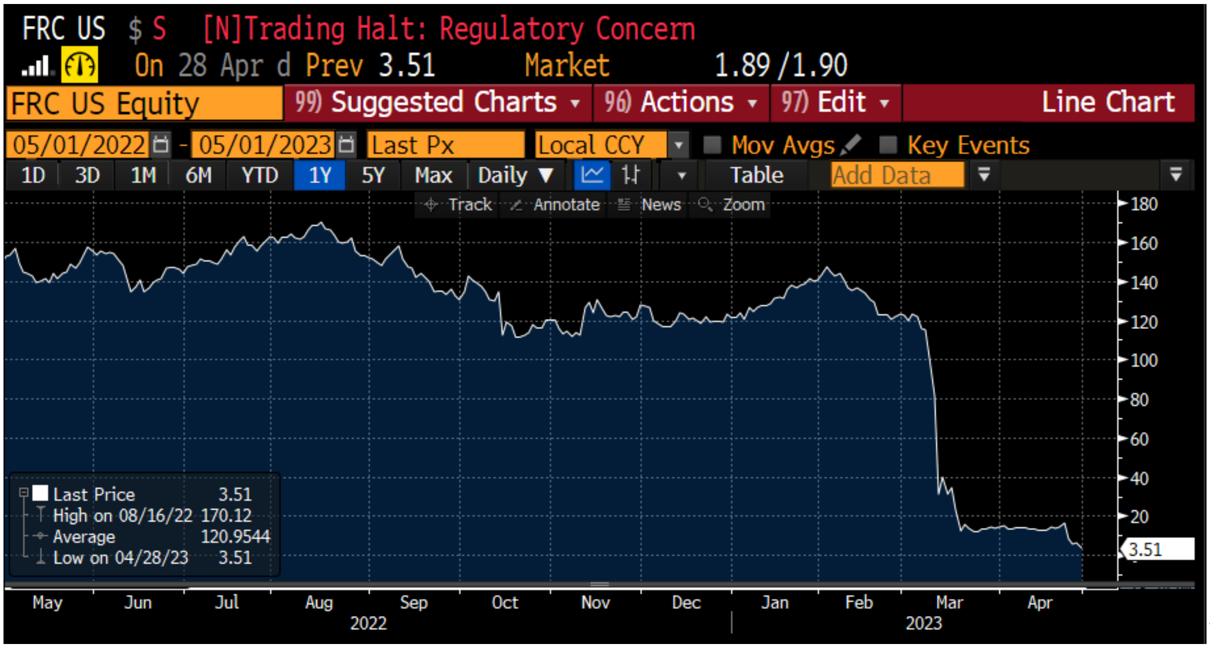
Banking Tremors



[1]

Roughly 15% of First Republic's revenues stem from their wealth management business unit- which was constructed of about 200 financial advisors and $270B in assets[2]. Most of these assets aren't likely held at the bank itself. As is the case with most of the wealth management industry, they were likely held at a custodian like BNY Pershing, or Fidelity.

But that's not a saving grace. If you're a wealth advisor, you can't hang your hat at a notoriously insolvent bank. Regardless of where your client's assets are parked.

When stories began to circulate of large advisor teams fleeing the bank, the writing was on the wall for the bank as a whole.

The wealth management industry has been dominated by large, and even mid-sized, banks for decades. FRC was the 14th largest bank in the country[3]. Bigger than SVB. The pitch that has been sold by these banks to their clients has been "we are your personal bank, we can underwrite your mortgage, we can help with your business' loan, we can lend you a personal line of margin, we can manage your assets- all under our roof."

In a perfect world, and to the majority of people who are seeking financial guidance that don't swim in the financial services industry all day long, this pitch makes perfect sense. One big, clean, turnkey solution.

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[1] Chart provided by Bloomberg database.

[2] Data provided by company filings.

[3] Data provided by Bloomberg database.

But we live in reality, not a perfect world. So, when an adviser has sold a vision to their clients that "we can do it all", they perceive *you as responsible for all of it-* even if you and your team were solely focused on their portfolio. You live and die by the letterhead.

The case for independent advisors has been strong long before the banking tremors of 2023. But the events over the last few months are real time case studies as to why everybody, but especially individuals and families with sizable assets, or large closely held businesses, should be seeking out or structuring their own independent advisory relationships. More than $110T have migrated to independent advisory and family office relationships in the last 20 years[4]. That number isn't going to shrink anytime soon.

The vision of an all-encompassing wealth management relationship that was drawn up by the legacy names in this industry wasn't completely flawed. But the one thing that was left out in the value proposition to prospective clients was objectivity.

Mutation

Anytime you've had a bank failure, you've clearly had a failure in bank management. Both inside and outside the walls of the proverbial vault. From client profile concentration, deposit size concentration, liquidity risks, regulatory risk- the list goes on for the items a bank needs to be consistently on top of from a risk management perspective.

For the last month or so, we've been in a phase of this banking tremor where capital flight has been a significant culprit as to what's set off the alarms. There's no getting around it. If deposits at these banks had been stickier, then we wouldn't be sitting in the ashes of three bank failures in a 5-week span, wondering what's next.

A decade-plus of accommodative monetary policy has masked an entire underbelly of poor risk management by many of these institutions, and their customers. The word "idiosyncratic" or "contained" has been used to describe what's transpired to this point. But I must ask the question, how many idiosyncratic events do you have to have before you've stumbled into something systemic?

Jaime Dimon confidently declared 'this part of the crisis is over' shortly after the news just broke that his bank had just purchased First Republic for pennies on the dollar. Some have taken this as a signal that we're in the clear. I think that's an optimistic take. I think he is referring to the next ripple that's on the horizon.

During the pandemic, so many of us thought we'd beaten Covid-19. Just for a new variation to show up and repeat the cycle. The next mutation, or variant, of this banking fallout is likely to come in the form of the chronic mismanagement of risk that's gone unnoticed. After a year of warp speed interest rate hikes, we were destined to see just what parts of the economy would show were the weak links. This started with the housing market coming to a halt last year, and now we've seen it metastasize into these regional banks. There's no guarantee there won't be additional rate hikes into this summer, and as the impact of the first 500bps of this cycle continued to impose its will on the economy; there could be more weaknesses out there that we haven't recognized yet.

[4] Financial Advisor Magazine, June 2021.

LEGAL STUFF

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