ROCKEFELLER
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CIO MONTHLY PERSPECTIVE

SKIRTING THE MAGINOT LINE

OLD-FASHIONED BANK RUNS IN INTERNET TIME

At the time of this writing, several banks have collapsed, and a few others are still fighting for survival.

Courtesy of Wikimedia

INTRODUCTION

On February 13, a well-known and colorful market strategist wrote that he had a eureka moment – he made the keen observation that the Fed's massive bond holdings, courtesy of years of quantitative easing, had absorbed much of the rate hike induced bond losses that would have hit the private sector in past cycles. It helped explain why the economy has held up so well in the face of rapidly rising rates – the Fed, rather than the banks, has acted as the shock absorber. However, less than a month later, Silicon Valley Bank revealed that many banks were not immune to rising rates, and the damage to their financial health was papered over by not being required to mark to market their fixed income investments. Once the cat was out of the bag, fear-mongers went full throttle on social media to stoke angst about the safety of bank deposits, and a crisis of confidence was set in motion. At the time of this writing, several banks have collapsed, and a few others are still fighting for survival.

For some investors, the banking crisis has triggered PTSD (post-traumatic stress disorder) from the Great Financial Crisis (GFC), even though the 1980's savings and loans crisis may be a closer comparison. The situation does not have to devolve into systemic shocks if regulators can respond with appropriate policies. So far, the Fed has answered the challenges by facilitating banks' access to liquidity and signaling flexibility on policy rates. Risk assets have mostly reacted positively on the hope that the Fed will soon start cutting interest rates to ease financial conditions. The prospect of a return to easy money turbocharged cryptocurrencies and, ironically, crypto bros were gloating about Bitcoin being safer than bank deposits. Their collective amnesia over the likes of FTX and LUNA, just to name a few, is simply breathtaking.

As discussed in my last report, *The Plot Thickens*, the conclusion of the Fed's hiking cycle will mark the start of the final act of the pandemic-induced boom-bust play –the Landing. Unfortunately, the odds of a hard landing have risen materially in the wake of the banking crisis. As Shakespeare wrote in *Henry IV*, "The better part of valor is discretion." There is no need to be a hero in the face of rising macro risks, and I would still remain patient, selective, and defensive.

JIMMY C. CHANG, CFA®

Chief Investment Officer
Rockefeller Global Family Office
jchang@rockco.com
(212) 549-5218

Fighting the last war

History can be cruel to some accomplished but unlucky figures. Instead of being hailed as a visionary who had successfully defended France from fascist attacks, André Maginot's last name has come to symbolize backward-looking, outdated mindsets – the quip that generals always fight the last war.

Maginot was a man of duty, courage, and vision. When he was appointed as France's Under-Secretary of State for War in 1913 at the age of 36, he foresaw an imminent war with Germany and prepared his country accordingly. When the Great War broke out in August 1914, instead of staying in Paris as an official, he volunteered to fight on the front line as a private and was later promoted to sergeant. He served with distinction and had a leg shattered by enemy fire during a daring raid, which left him with a limp for the rest of his life.

Upon returning to the civilian government in 1917, he served in a number of key posts, including several stints as the Minister of War. Maginot played a leading role in honoring fallen soldiers and was popular with American veterans. He continued to advocate for military readiness in the 1920s even though many believed that the once-mighty German military had been defanged by the Treaty of Versailles – the treaty limited the German army, or Reichswehr, to 100,000 men and forbade conscription and the maintenance of an air force.

In 1926, France learned that the Reichswehr had established a covert rearmament deal with the Soviet Union in 1921. With Germany having a far larger population and economy, French military chiefs knew that they could not win a war against them on its own. Amidst the US pursuing an isolationist policy and the British Empire focusing on fiscal rather than security interests, the French military began planning for a defensive strategy that would make it extremely costly for a rearmed Reichswehr to attack France. In the absence of a natural defensive barrier like the Rhine River, French generals, drawing on their experience from the Great War where a few well-fortified machine gun posts could effectively repel a large invading army, proposed the construction of a line of concrete fortifications on France's eastern and northern borders. André Maginot was an ardent advocate of this defensive strategy, and his active lobbying swayed the Parliament to allocate 3.3 billion francs toward the project. Construction started in 1929 under his supervision as the Minister of War.

Maginot did not live long enough to witness the completion of the project; he died of typhoid fever at the relatively young age of 54 in 1932. His passing was mourned on both sides of the Atlantic Ocean. The New York Times praised him as "physically a giant" and "bighearted." The French memorialized him by naming the defensive fortifications *La Ligne Maginot*, or the Maginot Line.

Market Watch

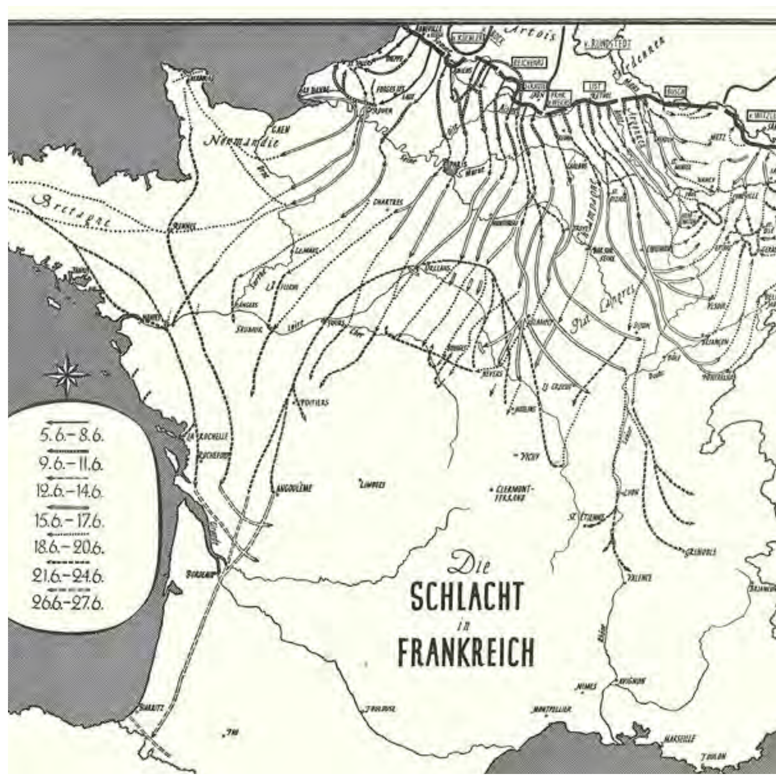
Equity Market Indices[1]	2/28/23 Price	3/31/23 Price	MTD Change	YTD Change
MSCI All Country World	629	647	2.8%	6.8%
S&P 500	3970	4109	3.5%	7.0%
MSCI EAFE	2054	2093	1.9%	7.6%
Russell 2000®2	1897	1802	-5.0%	2.3%
NASDAQ	11456	12222	6.7%	16.8%
TOPIX	1993	2004	0.5%	5.9%
KOSPI	2413	2477	2.7%	10.8%
Emerging Markets	964	990	2.7%	3.5%
Fixed Income				
2-Year U.S. Treasury Note	4.82%	4.03%	-79	-40
10-Year U.S. Treasury Note	3.92%	3.47%	-45	-41
BBG U.S. Agg Corp Spread	1.24%	1.38%	14	8
BBG U.S. HY Corp Spread	4.12%	4.55%	43	-14
Currencies				
Chinese Renminbi (CNY/$)	6.94	6.87	-0.9%	-0.4%
Brazilian Real (Real)	5.24	5.06	-3.3%	-4.1%
British Pound ($/GBP)	1.20	1.23	-2.5%	-2.1%
Euro ($/Euro)	1.06	1.08	-2.4%	-1.2%
Japanese Yen (Yen/$)	136.17	132.86	-2.4%	1.3%
Korean Won (KRW/$)	1323.06	1301.85	-1.6%	2.9%
U.S. Dollar Index (DXY)	104.87	102.51	-2.3%	-1.0%
Commodities				
Gold	1827	1969	7.8%	8.0%
Oil	77.1	75.7	-1.8%	-5.7%
Natural Gas, Henry Hub	2.75	2.22	-19.3%	-50.5%
Copper (cents/lb)	410	409	-0.1%	7.5%
CRB Index	270	268	-0.8%	-3.6%
Baltic Dry Index	990	1389	40.3%	-8.3%

Source: Bloomberg

The Maginot Line is a military and engineering marvel. It featured elaborate networks of fortifications and military facilities such as observation, artillery and machine gun posts, infantry shelters, barricades, communications centers, supply depots, and power generators connected by underground tunnels and rails. These facilities even had air filters to guard against poison gas attacks, which were frequently deployed during the Great War.

The Maginot Line was initially intended to stretch from the Mediterranean Sea to the English Channel, meandering along France's borders with Italy, Switzerland, Germany, Luxembourg, and Belgium. However, construction of the defensive barriers along the border with Belgium was halted for several reasons. With France and Belgium having signed a collective defense pact in 1920, building fortifications along the Franco-Belgian border would have made the former look like an unreliable military partner. French generals also believed that the Ardennes, a region of dense forests and rough terrain covering eastern Luxembourg, southern Belgium, and northwestern France, was an impenetrable natural barrier. After Belgium annulled the defense treaty with France and declared neutrality in 1936, France tried to extend the Maginot Line but ran into engineering, budget, and weather issues.

The Maginot Line, the most expensive military project ever undertaken at the time, wound up being a mere historical footnote and did not stop Hitler from conquering France. The widely accepted narrative is that the Maginot Line was poorly conceived with WWI's trench warfare in mind, and that the German army simply bypassed it and caught the French military by surprise with its blitzkrieg through Belgium. The Maginot Line has become a metaphor for backward-looking and costly efforts that provide a false sense of security. To be fair to André Maginot and his fellow advocates for the Maginot Line, this expensive project had actually worked as intended by French military strategists. It successfully diverted the German army to Belgium, which spared French soil from being ravaged and allowed France to concentrate its military forces in a single war theater rather than being spread too thin along its stretched borders.



Map of German advances in France in June 1940, [*Courtesy of Wikimedia*]

The Allies – the French military and the British Expeditionary Force – had plenty of time to prepare for the epic Western Campaign in Belgium as the battle took place eight months after their September 1939 declaration of war on Germany. In May 1940, on the eve of the campaign, each side had deployed about 3.3 million troops, but the Allies boasted the numerical dominance with guns, tanks, and motorized vehicles. The German army was only ten percent motorized and its logistical transport was still operated by horse-drawn vehicles. However, Germany had air superiority with its aircraft fleet outnumbering the Allies by roughly 2 to 1.

As the attacker, Germany was able to concentrate its forces to penetrate the Allies' weak points, overwhelming the Allies with the combined force of speedier tanks, mobilized infantry, artillery, and coordinated air strikes. France was unfortunately stuck in the past as they still perceived tanks as infantry support vehicles. The French also had a rigid top-down command structure and mostly utilized telephone lines rather than radio communication to relay information, not realizing the vulnerability of phone lines being easily cut off. By contrast, the German tanks were equipped with radio communication for real-time battlefield coordination, and junior officers were empowered to make agile field adjustments.

The battle started on May 9, 1940, and quickly turned into a rout. The German military gambled on speed, using the famed blitzkrieg attack strategy to deeply infiltrate French defensive lines to disrupt and encircle the French units. Six days later, French Prime Minister Paul Reynaud telephoned Winston Churchill, the new British Prime Minister, with the dire news that the French had been defeated. Churchill flew to Paris on May 16 to coordinate the defense of France, only to find out that the French government and military was on the brink of collapse. Churchill returned to London with a sense of foreboding and soon ordered the Dunkirk evacuation to bring home the British Expeditionary Force.

The French surrendered on June 22, 1940, just six weeks after the start of the Western Campaign. Ironically, neither side had anticipated the war to be so lopsided. French generals were indeed fighting the last war as they had sought to drag Germany into a war of attrition while Hitler was prepared to lose a million soldiers to conquer France. He wound up taking France with only 27,000 German soldiers killed in combat.
In Churchill's 1949 memoir, *Their Finest Hour*, that recounted the events from May to December 1940, he recalled what then French Commander-in-Chief, General Maurice Gamelin, glumly said on May 16 about his country's humiliating defeat, "*Inferiority of numbers, inferiority of equipment, inferiority of method.*" Indeed, it was Gamelin's use of WWI methods to fight WWII that led to France's defeat, not the static Maginot Line which did exactly what André Maginot had intended.

Richard the Prophet

On July 16, 2014, then Dallas Fed President Richard Fisher delivered a speech titled *Monetary Policy and the Maginot Line*. Fisher, a rare breed of Fed official who had run a hedge fund, did not mince words about the danger of the Fed's ultra-loose monetary policy.

Fisher cautioned that, "When money is dirt cheap and ubiquitous, it is in the nature of financial operators to reach for yield." He disputed the prevailing view that "macroprudential supervision" would prevent financial excess from creating instability. "Macroprudential supervision," according to him, "is something of a Maginot Line: It can be circumvented." He added, "Relying upon it to prevent financial instability provides an artificial sense of confidence." Fisher also said that the Fed had overstayed its welcome by keeping the monetary policy too loose for too long.

Fisher's open disagreement with his colleagues on the Federal Open Market Committee (FOMC) did not seem to earn him much goodwill from an institution that tends to embrace groupthink, and from the obsequious media that covers it. When he left the Fed in the following March, the New York Times sent him off with the headline, "*Richard Fisher, Often Wrong but Seldom Boring, Leaves the Fed.*"

Fisher's former colleagues and market pundits had good reasons to push back against his warnings. Most market participants reveled in the easy-money world, and many regulators truly believed that the landmark "Dodd-Frank Wall Street Reform and Consumer Protection Act," signed into law by President Obama in July 2010, would effectuate sufficient macroprudential supervision to prevent another financial crisis.

Indeed, when asked at a conference in 2017 about the next financial crisis, then Fed Chair Janet Yellen replied, "You know probably that would be going too far, but I do think we're much safer and I hope that it will not be in our lifetimes, and I don't believe it will be." Her reasoning was that regulators were "doing a lot more to try to look for financial stability risks that may not be apparent" thanks to "a more appropriate system of supervision and regulation."

Fast forward to March 2023, to the surprise of regulators, rating agencies, and investors, the much-admired Silicon Valley Bank, which ranked 20th on the annual Forbes America's Best Banks List published just a month earlier, suddenly collapsed just as Fisher had warned nine years earlier – its aggressive reach for yield finally backfired, and the artificial sense of confidence created by macroprudential supervision was shattered. It was also apparent that Yellen had severely underestimated her audience's longevity in 2017.

The Fed giveth, the Fed taketh away

Conceived by its two founders over a poker game, Silicon Valley Bank ("SVB") was established in 1983 to provide banking and credit services to technology startups in Silicon Valley. It later expanded into private banking and financing services for venture capitalists and had adroitly navigated the dot-com bubble implosion as well as the Great Financial Crisis (GFC). In 2012, Silicon Valley Bank even teamed up with a Chinese bank to set up a branch in Shanghai to facilitate its venture capitalist clients' gold rush to China and Chinese startups' foray into American capital markets.

SVB's unique tech-focused strategy was so successful that its stock had significantly outperformed major indices and attracted legions of loyal investors. From its initial public offering (IPO) in November 1987 to the end of 2019, its stock had generated a 20.6% annualized total return, far outstripping the S&P 500 Index and the NASDAQ Composite (10.85% and 11.75%, respectively).

In early 2020, in response to the pandemic-induced free fall in the economy and financial markets, the Fed came to the rescue by shifting its easy money policy into overdrive. The flood of liquidity propelled valuations of public and private technology companies to the stratosphere and turbocharged Silicon Valley Bank's business like never before.

With venture capitalists, tech companies, and their executives flush with money, the bank's deposits tripled in merely two years, from $62 billion at the end of 2019 to $189 billion by the end of 2021. Its share price gained 170% cumulatively from the start of 2020 to the end of 2021, or 64% annualized, far ahead of major indices by huge margins.

As deposits surged, management had to figure out how to put the money to work. There were basically two options for the bank to generate interest income from the tsunami of deposits: make more loans or purchase more securities. Since the bank could not have underwritten loans at a pace commensurate with the influx of deposits, it naturally put most of the inflow into fixed income securities. Management boasted that the bank had a high-quality, liquid balance sheet with cash and fixed income securities capturing 60% of the assets. Additionally, more than 90% of the fixed income securities were in ultra-safe US Treasuries and mortgage-backed securities.

While the Fed's largess greatly benefited SVB with tremendous deposit growth, it suppressed the bank's interest income by keeping interest rates artificially low. SVB had to stretch the duration of its fixed income portfolio – holding more longer dated bonds – to realize somewhat higher yields. The risk with such a strategy is heightened interest rate sensitivity – rising interest rates would lead to material paper losses in its bond holdings. However, bankers and investors were assured by the Fed that rates would remain so low for so long, as Chair Powell said in June 2020, "We are not even thinking about thinking about raising rates." When Fed Chair Powell indicated in November 2021 that the word "transitory" should be retired in characterizing inflation, astute investors realized that the easy money induced good times for Silicon Valley and its chief banker were about to end. The NASDAQ Composite and Silicon Valley Bank's stock both peaked during that month.

The Fed's aggressive tightening – jacking up the upper bound of the Fed funds rate to 4.5% by year end 2022 despite having guided to a mere 1% a year earlier – quickly eroded the market value of Silicon Valley Bank's investment portfolio. For all of 2022, it was not a problem as accounting rules did not require the bank to recognize much paper losses as long as the bonds in its investment portfolio were categorized as being held to maturity.

One of the early victims of the Fed's aggressive tightening cycle was the Silicon Valley ecosystem, as rising interest rates popped the tech bubble and ended the IPO prospects of many startups. Unable to tap the public market and with venture money drying up, many startups had to draw down their deposits at Silicon Valley Bank. The downward spiral started when deposits were leaving so fast that SVB had to sell bonds at a loss to meet withdrawals, which quickly eroded its capital cushion.

To shore up its capital base, the bank announced an unexpected capital raise, which shocked investors and caused its share price to plunge by 60% in a single trading session on March 9.

Next came the fateful bank run courtesy of the market's ghastly reaction to SVB's stock price collapse. SVB's clients were not the typical mom and pop accounts with less than $250,000 of deposits, the threshold above which receives no deposit insurance from the Federal Deposit Insurance Corporation (FDIC). 97% of SVB's domestic deposits were uninsured as its carefully cultivated clientele were mostly high net worth and corporate accounts with sizable deposits.

As the bank's share price collapsed, many of its clients suddenly realized that their deposits were no longer safe should the bank go belly up. Venture capital firms such as Founders Fund, Coatue Management, and Union Square Ventures all advised their portfolio companies to get their money out. All told, the bank's customers tried to withdraw $42 billion on March 9, one-fifth of the banks' $212 billion of assets at year-end 2022.

By the following morning, the withdrawal had swelled to $100 billion. There was no way that any bank could satisfy withdrawals on such a scale, and regulators had no choice but to put SVB into receivership. In the end, it was an old-fashioned bank run perpetrated by SVB's innovative and forward-thinking clientele that sealed the fate of the storied franchise in a valley known for turning sand into gold.

BANK RUNS IN THE INFORMATION AGE

Silicon Valley Bank's sudden collapse sent shock waves across the market and demonstrated that bank runs can happen nearly instantaneously in Internet Time – fear can spread quickly via social media, and depositors would pull money out electronically rather than having to queue up in long lines outside bank branches.

Realizing that many other banks also have sizable unrealized losses – aggregate unrealized losses in the US banking system stood at $620 billion at the end of 2022 – the Federal Reserve quickly came up with the Bank Term Funding Program (BTFP) to provide additional liquidity to banks. The BTFP let banks post eligible bonds – US Treasuries, agency securities, agency mortgage-backed securities – as collateral to borrow money from the Fed, which would obviate the need to sell these bonds at a loss. The Fed also generously valued the collateral at par rather than at their much lower market prices.

To limit the damage of SVB's collapse, Treasury Secretary Yellen announced a systemic risk exception for the bank, which allowed the FDIC to guarantee all deposits – insured and uninsured – of the bank's wealthy and corporate clients. A similar exception was also applied to Signature Bank, which was put into receivership to the surprise of one of its board members, Barney Frank of the Dodd-Frank Act fame.

While these measures should have theoretically restored confidence and prevented bank runs, many banks continued to bleed deposits and stocks of a few regional banks were ravaged by short sellers.

First Republic Bank suddenly found itself at the vortex of the financial maelstrom as depositors reportedly pulled out more than $70 billion in less than two weeks. At the behest of the Treasury Department and led by JP Morgan, a group of eleven financial institutions organized a rescue plan and deposited $30 billion into First Republic. Across the pond, plunging confidence in the soundness of counter parties prompted Swiss regulators to force a shotgun marriage between UBS and Credit Suisse – the latter was bought out for roughly $3.25 billion while $17 billion of its Additional Tier-One (AT1) bonds were wiped out.

At this point, the banking crisis is more reflective of the fragility of confidence rather than the system being fundamentally broken. The instantaneous nature of information dissemination and financial transactions coupled with jittery sentiment can quickly endanger otherwise healthy financial institutions. Another problem is the arbitrary nature of the government's application of systemic risk exceptions in deciding which banks' uninsured deposits would be made whole. It has the unintended consequence of penalizing smaller banks as it would behoove depositors, especially business entities with more than $250,000 at local community banks to move their money to the so-called too-big-to-fail banks just in case their local banks get hit with unjustified bank runs.

An effective solution to these issues is for regulators to offer blanket insurance to all deposits, which would immediately halt bank runs. Of course, such a move raises the issue of moral hazard as a blanket deposit guarantee could induce riskier behavior among bankers and depositors. As such, lifting the deposit insurance threshold will need to be coupled with new regulatory measures as well as a more equitable way to fund it.

To the chagrin of investors, these measures need to be enacted by Congress, which will take its time for deliberation, a luxury that a jittery market cannot afford. Ultimately, it may take more market turmoil to force regulators to get creative in coming up with an emergency temporary deposit insurance scheme as requested by the Mid-Size Bank Coalition of America (MBCA) to the FDIC.

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Beyond the deposit insurance issue, banks are also confronted with the flight of deposits into higher yielding money market funds. Many banks will need to raise their deposit rates to be competitive, but it will materially reduce their profitability. Unfortunately, just like the savings and loan crisis, many weaker players will be squeezed out of existence.

Dodd-Frank's Maginot Line

In an era of hyper partisanship, politicians were not going to let a crisis go to waste – they quickly turned the Silicon Valley Bank debacle into political football. Democrats blamed Trump for signing into law a Republican-led bill in 2018 that rolled back some bank regulations. However, it was a bipartisan bill that had the support of 17 and 33 Democrats in the Senate and the House, respectively. Republicans spun the FDIC's guarantee of all SVB deposits – insured and uninsured – as a bailout of woke billionaires and the Democrats' donor base.

To be fair, Congress and regulators all bear some responsibility for this unfortunate crisis, as the fiscal and monetary overstimulation in 2021 had fueled financial bubbles and inflation, which then forced the Fed to tighten at the fastest pace in more than forty years. SVB had clearly benefited from the overstimulation but was eventually undone by the sizable investment losses induced by the Fed's aggressive tightening. On the regulatory front, it is debatable whether the stress test that SVB would have been subject to could have identified the bank's fatal flaws – SVB was spared the onerous annual stress test after the 2018 bill amended the Dodd-Frank Act and lifted the asset threshold for tighter regulatory scrutiny from $50 billion to $250 billion.

The Dodd-Frank Act was designed to fight the last war – preventing a repeat of the Great Financial Crisis, which was caused by banks owning too much toxic assets and having insufficient capital to absorb losses. As such, Dodd-Frank required banks to hold more capital and have greater exposure to safe and liquid assets such as US Treasury and agency mortgage-backed securities. The annual stress tests for the so-called too-big-to-fail banks tend to focus on these institutions' ability to withstand deeply recessionary conditions that would materially push up credit losses to erode their regulatory capital.

Silicon Valley Bank would have passed these stress tests with flying colors as its large holdings of US Treasuries and mortgage-backed securities have minimal credit risk. SVB's bond values would have appreciated in stress test scenarios because interest rates tend to drop during recessions. What these stress tests failed to anticipate was the duration risk – sharp declines in bond values caused by rapidly rising interest rates – and the concentration risk in a bank's client base.

Congress will likely appoint an inspector general to investigate the Fed's regulatory lapses over Silicon Valley Bank. The San Francisco Fed will be put through the wringer for not having exercised more scrutiny on SVB as it has the authority to subject banks with more than $100 billion of assets to stress tests. It does not help optically that Greg Becker, now the ex-CEO of SVB, was one of the three Class A directors on the San Francisco Fed's board. Mary Daly, the district Fed's President, has already come under fire by conservatives for her high-profile advocacy of climate, diversity, equity, and inclusion issues. While her activist agenda is well-intentioned, the Fed may not have been inclusive with the diversity of ideas. One can argue that more independent thinkers and internal critics like Richard Fisher are needed to challenge the institution's groupthink.

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Farewell, rate hikes

Besides the political blow back, the banking crisis has put the Fed between the proverbial rock and a hard place in monetary policy. The august institution needs to maintain both financial and price stability, but they currently demand different policy prescriptions. An easing bias should help assuage the banking crisis but risks leaving inflation elevated. On the other hand, further tightening to fight inflation risks fomenting more financial instability.

The Fed wound up with a dovish hike at the conclusion of the FOMC meeting on March 22. It raised the upper bound of the Fed funds rate to a cycle high of 5%, kept its year-end 2023 policy rate expectation at 5.125% (with the upper bound at 5.25%), but changed the language in the press release from "*anticipating that ongoing increases in the target range will be appropriate*" to "*some additional policy firming may be appropriate.*"

The market's interpretation of the Fed's tea leaves was decidedly dovish as US Treasury yields collapsed across the curve. Barring materially hotter-than-expected inflation data ahead, many suspect the Fed's rate hiking cycle that began a year ago has already run its course. Based on precedent, equities tend to rally when the Fed is perceived to have wrapped up a rate hiking cycle. Investors would understandably feel emboldened by the removal of monetary headwinds.

They can also pin their hopes on the soft-landing thesis until subsequent fundamental weaknesses become irrefutable. With the Atlanta Fed's GDPNow model currently projecting 2.5% annualized real growth for the first quarter, bullish strategists will not easily give up on their soft-landing narratives for the current business cycle. Many traders have also been excited that the recent increase in the Fed's balance sheet – up $366 billion in March to bring the balance sheet within 2.9% of its all-time high – has created supportive liquidity conditions for financial asset prices. On the negative side, the recent banking crisis has created funding issues for many banks. The upcoming earnings reporting season may trigger some aftershocks as regional banks will have to provide guidance on their profitability, capital adequacy, and deposit movements.

Notwithstanding these near-term market gyrations, I continue to hold a cautious view as the odds of recession have moved higher in the wake of the banking crisis. Facing higher funding costs and potential deposit flight, many regional and community banks are likely to tighten their lending standards, which will reduce the availability of credit to households and businesses. It is a matter of time before the damage inflicted by the most aggressive interest rate hiking cycle in four decades becomes more apparent in other parts of the economy – office and multi-family segments of commercial real estate,

leisure and hospitality, and eventually construction. As earnings estimates get revised lower and credit issues become more pronounced in the months ahead, equities will eventually feel a greater force of gravity.

With the Fed's rate hiking cycle likely in the rear-view mirror, investors should consider extending the duration of their bond portfolios. I prefer high quality over non-investment grade bonds at this point of the business cycle. Precious metals remain a preferred hedge on geopolitical and policy risks, especially when the Fed blinks and starts easing. The banking crisis has also created opportunities in bonds and preferred stocks of too-big-to-fail and well-capitalized regional banks. In short, it is still appropriate to play defense behind the Maginot Line, but one can take advantage of the rapidly evolving macro environment to opportunistically go on the offensive. Importantly, we need to keep an open mind on how this pandemic-induced market cycle may unfold differently – e.g., with still elevated inflation and the Fed's liquidity injection – so we don't wind up fighting the last war.

PRINCIPAL AUTHOR

JIMMY C. CHANG, CFA®

Chief Investment Officer
Rockefeller Global Family Office

EDITOR

JOAN PARK

Research & Strategy Specialist
Rockefeller Global Family Office

CREATIVE DIRECTOR

ROBERT J. HADLEY

Head of Brand Strategy
Rockefeller Capital Management

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