SVB Was Not the First Domino to Fall – And It Won't be the Last!

by Schiff Gold

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Over the past several months, Mike Maharrey and I have posted numerous articles that conclude the same way… the Fed is bluffing and when something breaks, they will fold. On every podcast, Mike has walked through exactly why this is inevitable.

Back in September, I laid out the math that showed *why* the Fed would fold and laid out a series of risks that may cause such an event. One of those risks was *"What if the financial markets freeze because there is a credit event somewhere?".*

Well, that *just* happened. Silicon Valley Bank (SVB) and now Signature Bank has collapsed. Sure enough, the Fed folded within 48 hours. They stood with the Treasury and FDIC and explained how they are stepping in to prevent systemic risks from spreading. They have established a new Bank Term Funding Program (BTFB) to allow banks to borrow billions and blah blah… Sure, okay. Everything is now fine, right?

Nope, sorry, it's not. SVB is just the latest domino. The dominos have been moving down the risk curve. It started in Crypto with Three Arrows Capital and Luna. Then FTX was exposed for being a fraud. We were told these issues were contained. *And they were*! SVB didn't collapse because of FTX contagion or anything related to Crypto. It collapsed all on its own because it was the next step along the risk curve. Let's do a quick replay…

SVB gets tons of cash and capital all through 2021. They have so much cash they don't have anywhere to put it. They could go into Treasury Bills, but that was yielding 0.25%, so they decide to take a bit more risk. They buy longer-dated treasuries to get more yield. NOT Bitcoin, NOT high-risk stocks. They bought some of the safest securities you can buy… U.S. Treasuries. The mistake they made was forgetting to hedge their interest rate exposure… whoopsie.

Fast forward 12 months… yields have been pushed higher by the Fed, and all those Treasuries have lost value. Forced to sell, SVB realizes huge losses, and poof… they gone! Were they surprised? Was the Fed surprised? Because anyone with a calculator wasn't surprised. This was *going* to happen; it was just about *when.* If it wasn't SVB, it would be someone else. This is what happens when the tide goes out, you see who has been swimming naked.

I won't link to every article on SchiffGold where this was discussed because it's essentially *every* article. I think Mike and I are pretty good analysts, but we don't have PhDs in Economics and our primary job is not about trying to protect the economy from systemic risks. How did we see this coming and the Fed, FDIC, and Treasury all missed it? No doubt I was early, I thought this would have happened months ago… but it was always going to happen!

What did the regulators just do?

The Fed has come out and said that anyone with "high quality" debt like Treasuries can pledge it as collateral and get back *par value* for up to a year. So, you bought a Treasury Note for $100 in 2021, it's now worth $95. Whatever you do… DO NOT SELL IT. Come to the Fed and they will give you $100 for the debt. Treasuries don't get dumped on the market and everyone is made whole. BOOM, everyone wins and problem solved, right?

Sure, for now. But let's think through a couple of things:

First, SVB was not the first domino to fall, and it won't be the last. The Fed just set up a program for a very specific issue. The next domino will likely be another issue. What then? Another emergency measure? If it doesn't pose systemic risks then maybe the domino will be allowed to fall. Where does the Fed draw the line? What is *systemic*?

Second, what if you are an unsecured bond holder or stock holder in a smaller regional bank? Well, the **government just said you are getting zero** if your bank collapses. So, do you really want to be a stock or bond holder in a small regional bank? Probably not. What does that mean?

Third, the FDIC just raised its insurance from $250k to basically infinity… overnight! I mean, that's like every insurance company dropping premiums to zero and saying that all claims will be paid in full without question. Sounds like a party at first, but the hangover could be deadly. The moral hazard here is undeniable.

Fourth, the Fed just guaranteed all US Debt at 100% of par value. What are the implications of this incredible Put in the market? If the market decides to test the Fed, they may end up printing boat loads of money.

What's next?

The Fed, Treasury, and FDIC just stood together and backed the entire US financial system. But really, this amounts to another big fat Band-Aid. The Fed also officially pivoted, as has been obvious for months. Sure, they may hike rates in 10 days, but that would just be to save face. Powell cannot come out, put a 50-point hike back on the table, and say *"The latest economic data have come in stronger than expected, which suggests that the ultimate level of interest rates is likely to be higher than previously* *anticipated" …* and then two weeks later not raise rates. That's not how you bluff! Then again **Goldman is already saying hikes are off the table**, so we shall see.

The broader market sees a 25% chance of no hike next week and is **now predicting that 50bps** is all the Fed has left in this entire rate hiking cycle. That's half of what it was a week ago. Well, it's going to be really hard to get inflation back down to 2% if the Fed is almost done hiking… but that's a future problem, right? I would be surprised if the Fed even made it another 50bps.

SVB was not FTX. SVB was a well-established and respected institution. Everyone can look in the rear-view mirror and understand why SVB collapsed, but it doesn't seem obvious until it happens. And wow! It happened really fast! The stock was trading at \$270 on March 8^{th} and on March 10^{th} it was worth exactly \$0. Holy smokes! **Powell *just* said everything looks fine on March 7th and 4 days later he is in emergency meetings trying to save the entire U.S. Financial System. That's not such a good look.**

In the end, the Fed has bought itself time, but it also likely just damaged its reputation and announced to everyone that they can talk tough but can't act tough. So, how much time did they buy? Is it more than a week? Probably. But we have seen this show before. Bear Stearns collapsed on March 14^{th}, 2008. It wasn't until 6 months later that the Global Financial Crisis started with the collapse of Lehman on September 15^{th}, 2008.

The Fed brokered the sale of Bear Stearns to JPM and bought itself 6 months. This time around, did the Fed buy 1 month, 6 months, a year? Impossible to know. But if I was a betting man, I wouldn't bet on more than 6 months. That means you still have time to protect yourself from the obvious outcome that lies ahead. *Buy an insurance policy with no counterparty and that needs no bailout. Buy some physical gold and silver!*

Blessings,

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