HILBERRY GROUP
WEALTH MANAGEMENT

March 17, 2023

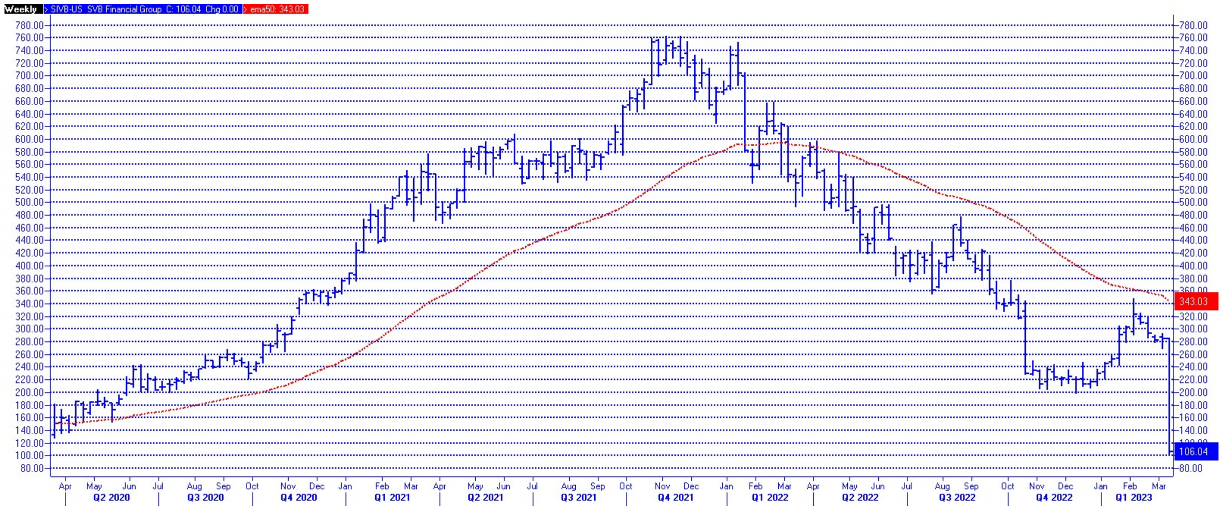
A Good Public Flogging Sharpens the Mind

With apologies to Samuel Clements quote on corporal punish, we've got a rebound in fear this week.

AAII Fear & Greed Index (more below)

https://www.aaii.com/sentimentsurvey

Silicon Valley Bank (SIVB-US-$106-halted) weekly 3 years



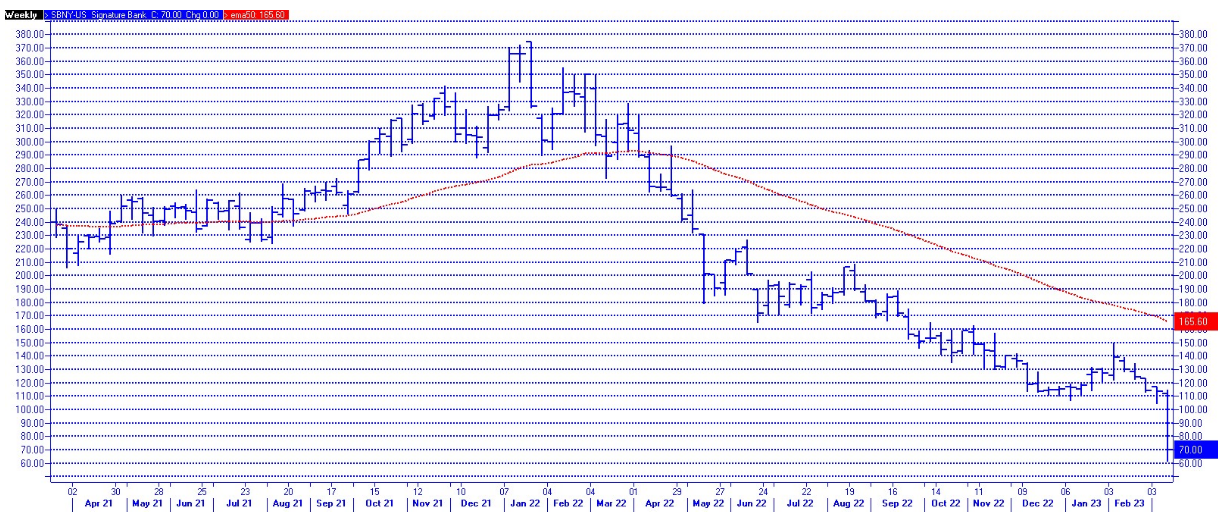
Source: Refinitiv – NBF - Hilberry

Silicon Valley Bank implodes

After we went to press last Friday, tech start-up focused Silicon Valley Bank suffered a good old-fashioned bank run, closed access to deposits and announced they were under FDIC supervision. The common shares of SVB company traded as high as $760 in Nov/2021. The stock collapsed on March 9th. Last trade $106 when trading was halted. SVB peaked the same week as Bitcoin, the FAANG stocks, Tesla and Cathie Wood's ARK Innovation Trust.

Purely coincidental, I'm sure.

Signature Bank of New York (SBNY-NSDQ-$70-halted) weekly – 2 years



March 12, New York based Signature Bank was closed prior to Monday's open after a similar runon deposits.

https://www.bankrate.com/banking/signature-bank-collapse/#why-did-it-fail

Signature traded as high as $374 in Jan/2022. Like SVB, SBNY shareholders are probably wiped out. If trading resumes for SVB and SBNY, we expect to see the shares trade for pennies, not dollars.

First Republic of San Francisco (FRC-NYSE-$34.27) weekly - 3 years.

First Republic wobbled this week. They appear to have been saved after Wall Street firms deposited $30 billion.

The above three geniuses were among a handful of US banks accepting crypto currency deposits. Accepting a fantasy cryptocurrency deposit can lead to fantasy capital ratios. The temptation to lend against such would have been hard to resist. Crypto-bulls dismiss this aspect. My guess is we'll find arrogance, hubris and incompetence a plenty.

Credit-Suisse (ADS's-CS-NYSE-$2.16 USD) – monthly – 10 years.

Credit Suisse was in the headlines this week, requiring and receiving assistance from the Swiss National authorities. CS has been having difficulties for years, posting 5 consecutive quarters of losses. The share price peaked in Nov/2007 around $77 and has been declining since.

The financial press breathlessly printed the 'C' word (contagion). Investors hit the SELL button for all things financial.

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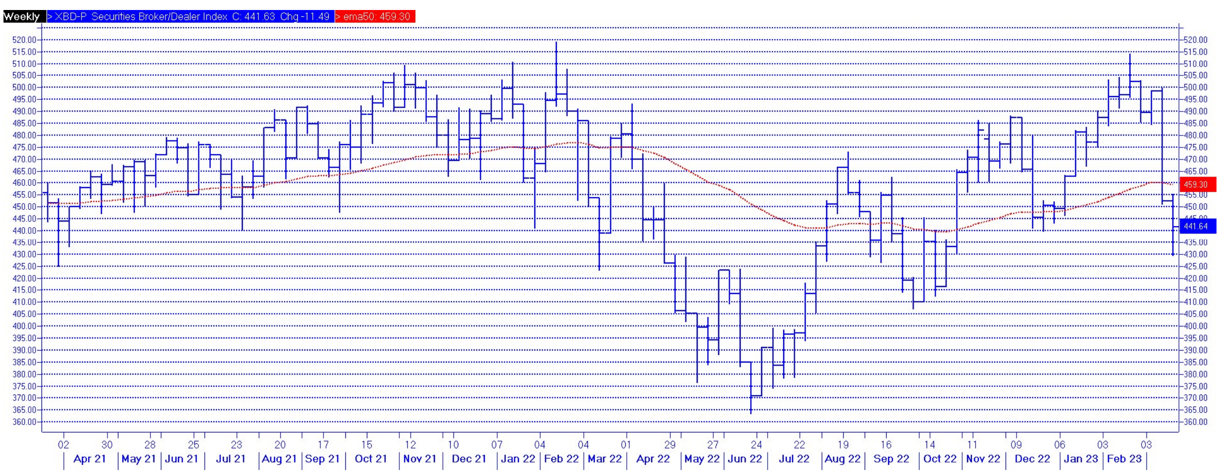
BANKS

Credit Suisse's Troubles Are Taking Bank Stocks and Others Down With It

By Brian Swint Follow and Adam Clark Follow Updated March 15, 2023 9:32 am ET / Original March 15, 2023 6:50 am ET

So…are all the US banks in trouble?

US Broker/Dealer Index (XBD-NYSE-441.39): weekly ranges | 2 years



The **US Broker/Dealer Index** (XBD-NYSE-441.39) provides the composite of publicly traded share prices for securities dealers. If anyone smells trouble, it will those holding shares in the dealers. It's been a useful indicator of trouble to come. Like the overall market, the XBD the index remains below the Jan/2022 market highs. In mid-Feb 2023 the index approached the previous peak signalling a turn in the economy. Then those clever folks way out west in California revealed the extent of their brilliance. The XBD crashed back down through the weekly moving average last Friday. It was down again this week – but less so. At this writing the XBD index remains well above the June/2022 lows hit when the S&P500 bottomed out (see below).

The XBD Index has been trading up from the Monday March 13 lows

US Broker/Dealer Index (XBD-NYSE-441.39): 15-minute intervals | 2 weeks

At this writing the XBD signals 'Whew'. Maybe

"It's only when the tide goes out that you learn who has been swimming naked."

– Warren Buffet

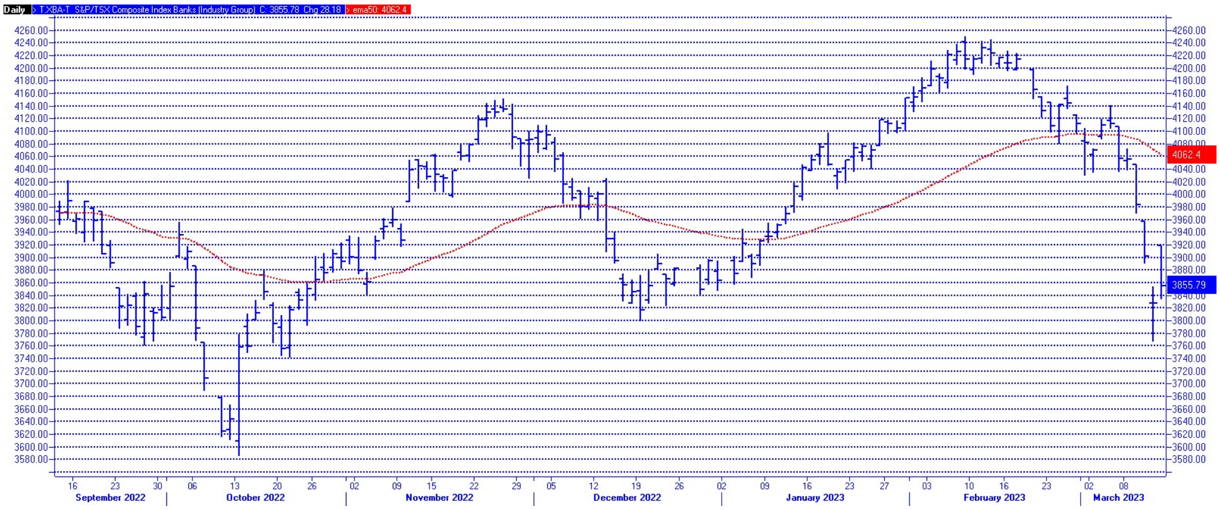
The resulting sell-off has some banks trading below 'Book Value Per Share' IE for less than their regulatory filings say each share is worth if the company was wound up.

Given the sudden collapse of SVB/SBNY, troubles at First Republic and Credit Suisse, this panic isn't surprising. Clearly 'Book Value' for <u>those firms</u> proved ethereal. *'Tossing the baby out with the bath water'* syndrome?

What About Canada's Banks?

The Canadian Bank sector went for a swoon too.

S&P/TSX Banks Index (XBA-3,784) – daily – 6 months March 15, 2023.



The Canadian Bank subgroup peaked in Feb/2022 around 4,770. At this writing the sector is down 20.6% from that high. The group is trading roughly 10% below the weekly moving average of 4,045.

Usually, one must pay at least a fair price for a great company. Investors holding such names are correctly loath to give up their future interest in earnings and dividend growth without a hefty premium for selling. *"No premium? No problem. I'll continue to hold."*

Rarely do we get the chance to pay a great price for a great company. Even less often are we able to have our pick of a basket of these kinds. We think this is one of those times. We saw the recent selling as a chance to buy great companies at great prices. We have been filling our boots with banks stocks and other sector names all week. EXAMPLE: Why would Canada's largest phone company, **BCE Inc (BCE-TSX-$59.83)** decline due to US bank problems? On Friday the US and Canadian markets were down again. The panic isn't done yet.

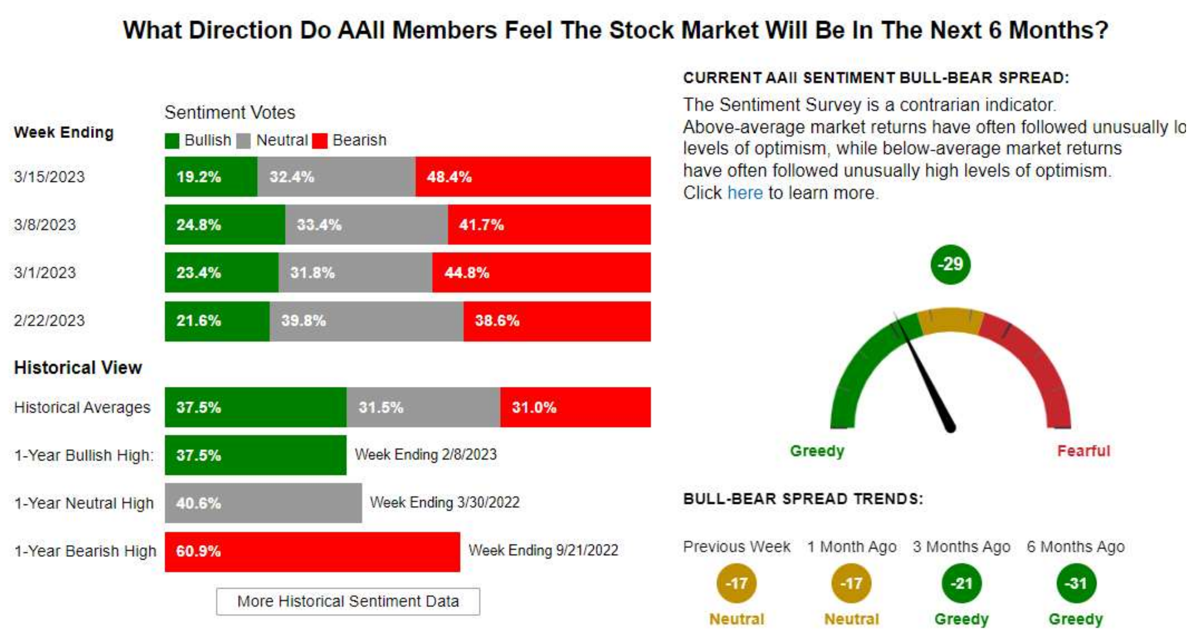
What direction interest rates?

As much of the above difficulties in banks stem from rising interest rates hitting their holdings (and crypto currency but that's another thing) what is our direction call on rates? For the past month we've predicted we're close to a short-term peak. This does NOT mean we believe 5-year mortgage rates will be below 3% again in our lifetimes. We don't think this is necessary for the kinds of companies we own to do well. For most of Steve's lifetime, let alone career, lending rates have been higher than the current ranges, yet stock prices have advanced more than declined for all of that period.

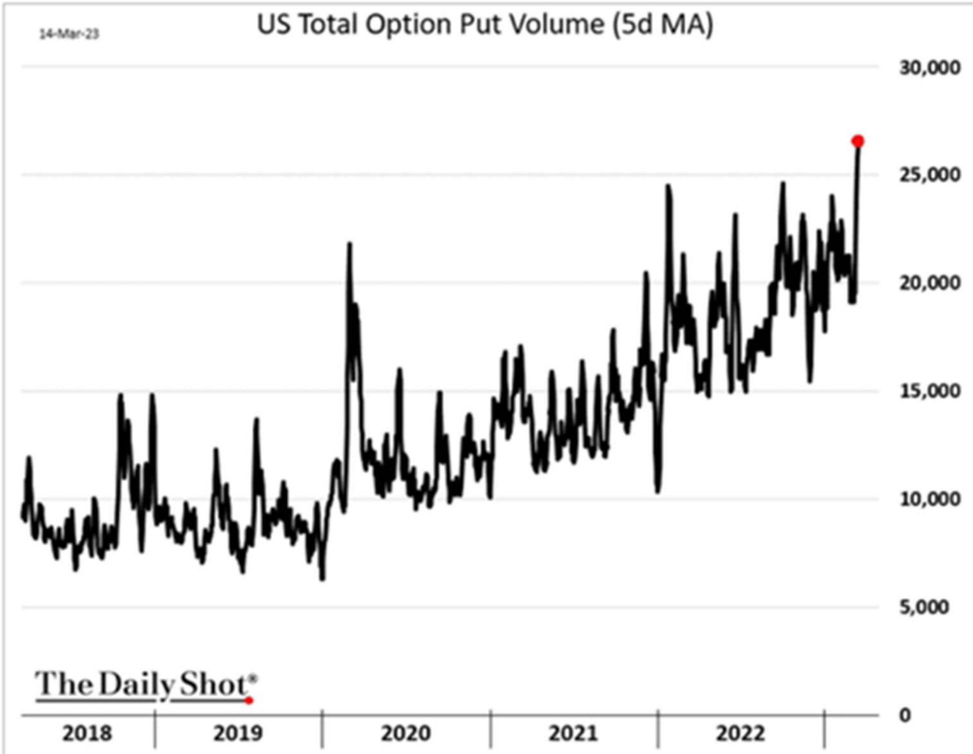
The shake out in the US banking sector has market mavens predicting a halt to rate hikes.

For the broader US equity markets….

The **American Association of Individual Investors (AAII)** weekly survey says their members are very nervous, showing bullish readings that 59% below normal while bearish readings are 49% above normal.

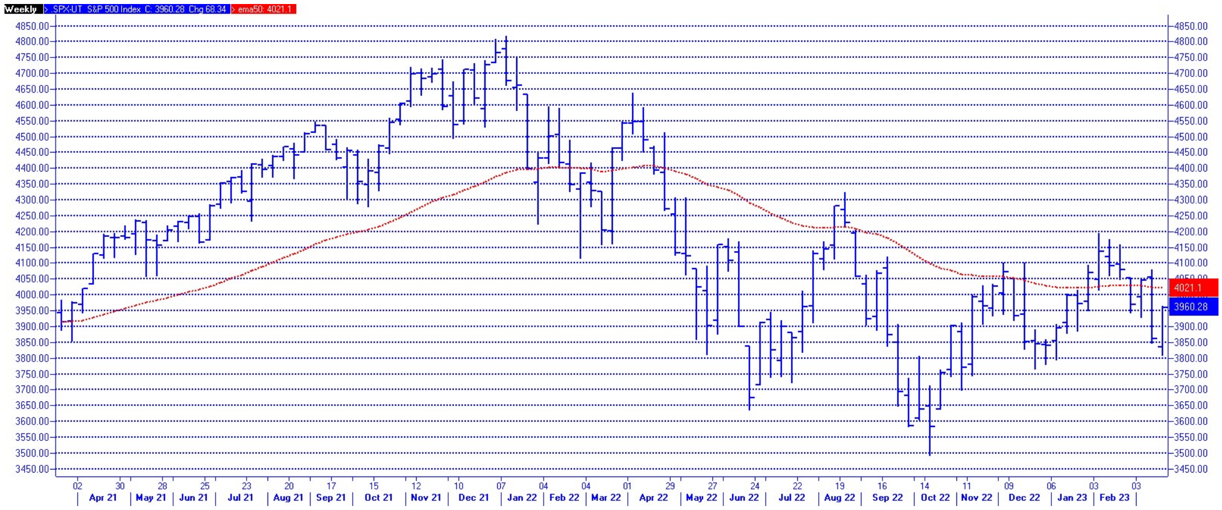


US investor demand for Put options (protecting downside price movements) are at multi-year highs.



Globally equity investors are extremely bearish, (red circle).

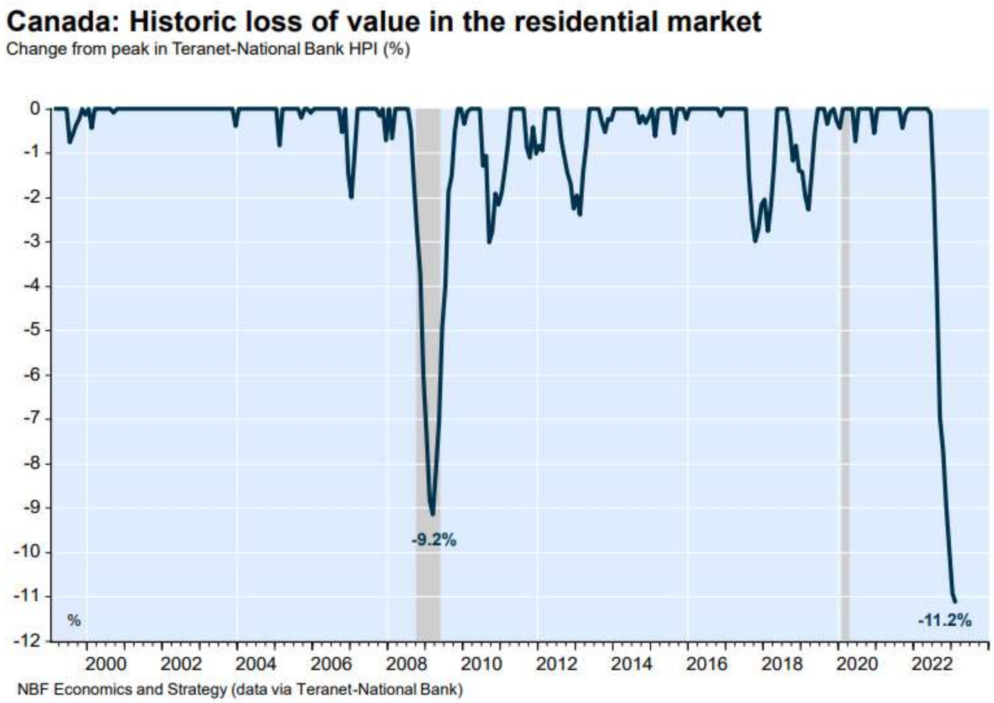
S&P500 (SPX-3960) – weekly – 2 years March 16, 2023



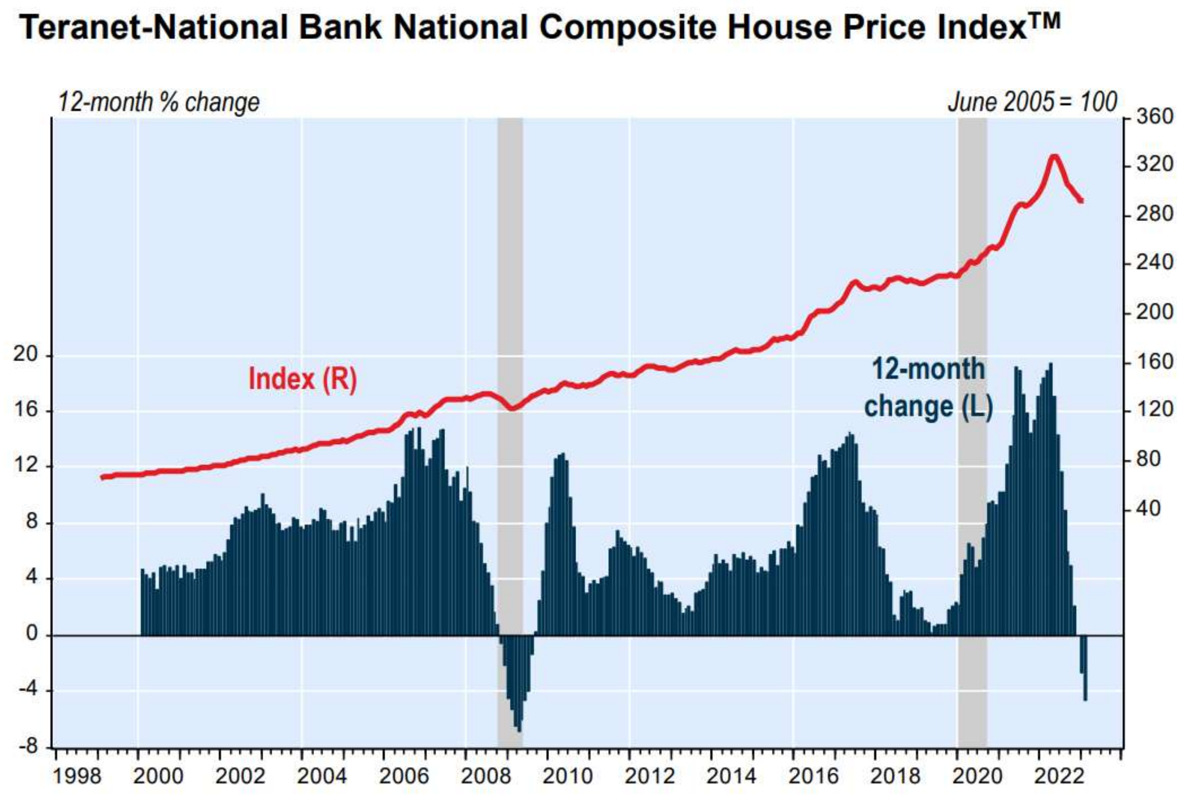
The S&P 500 peaked Jan 4, 2022 at 4,818 6 weeks after the FAANGS peaked in Nov/2022. It's been in a bear market since with lows of 3636 printed in Jun/2022. Peak to trough: **-24.5%.** Note that the June/2022 SP500 level of 3636 was the same level as Jan/2021 retracing the crazy 2021 blow-off stages of the COVID Bailout Bull. Most of the final run up inside the SP500 was concentrated in the same FAANGS that then melted down, evaporating that final puff of steam.

What about Canada's housing markets?

Teranet-National Bank House Price Index - Canada: Prices still down in February



We must keep these declines in context. 2018 to early 2022 was just plain silly with consecutive annual gains in the mid-teens…for a house that generates no profits.



Link to the full report

https://nbf.bluematrix.com/sellside/EmailDocViewer?encrypt=5e97c5aa-259d-4196-a59e-9b55b0a137ea&mime=pdf&co=nbf&id=steven.hilberry@nbc.ca&source=mail

We warned our readers and clients about irrational exuberance in Canada's housing markets. In Sept/2020 we provided the following tables projecting the impact of rising interest rates on mortgage servicing costs and borrowing power. At the time the lending rate was 2.5%. With $1,800 monthly cash flow and 10% down-payment available, the borrowing power was $401,200.

House price vs various interest rates			
Assumptions			
CMHC Ratio	90%		
Current monthly rent	$1,800	available to cover mortgage payment	
Mortgage Amortization	25 years	(300 months)	
Int. Rate %	Mortgage Principal*	Implied Down Payment	Total Purchase
10.0%	$198,100	$19,810	$217,910
9.0%	$214,500	$21,450	$235,950
8.0%	$233,200	$23,320	$256,520
7.0%	$254,700	$25,470	$280,170
6.0%	$279,400	$27,940	$307,340
5.0%	$307,900	$30,790	$338,690
4.0%	$341,000	$34,100	$375,100
3.0%	$379,600	$37,960	$417,560
2.5%	**$401,200**	**$40,120**	**$441,320**
2.0%	$424,600	$42,460	$467,060
1.80%	$434,600	$43,460	$478,060
*rounded to nearest $100			

Note the above table projects interest borrowing cost moving from 2.5% to 6% drops the total house price purchasing power $441,320 at 2.5% to $307,340 at 6%. While we thought prices would decline, we were not implying prices would drop by 30% (see next table). We thought inflation would rise from under 2% to over 3% (we used the latter figure). As we believed rates would rise, we were advising our client/borrowers to lock in for at least 5-years at those rates. We then asked what impact would rising interest rates have on those borrower's subsequent ability to cover their mortgage payments at higher mortgage borrowing rates when their term renewed in 5 years? Recall as time passes the principal is paid down. At the same time wages rise by usually inflation. If the borrower's economic value increases (more skills, higher pay) that can add additional mortgage servicing power.

Here is our guesstimate

What is the impact on future monthly payments at various future interest payments?					
Lenders typically require borrowers to able to cover a 4-5% cost					
Assume current 2.5% financing rates for 5 years.					
Assume original downpayment of		$40,120			
In 5 year Sept 2025 the remaining principal outstanding would be approximately				$339,656	
Net Equity with no growth in house prices				$101,664	
Remaining financed amoritization		20 years	240 months		
What happens to the monthly renewal payment in 5 years if interest rates have moved to….					
Assume income grows at 2% per year		**$1,987**	Future monthly income @CPI		
Assume wage earner improves value by 15%		**$2,285**	Future monthly income @CPI+3%		
Remaining Balance outstanding		**$339,656**			
	5 yr Renewal Monthly Payment				
3.0%	$1,883.00				
3.6%	**$1,987.00**				
4.0%	$2,058.00				
5.0%	$2,241.00				
5.23%	**$2,285.00**				
6.0%	$2,433.00				
7.0%	$2,633.00				
8.0%	$2,841.00				
9.0%	$3,056.00				
10.0%	$3,277.00				

It looked like a borrower who paid down their mortgage over 5 years and improved their earnings power would be in roughly the same net income carry cost position at 5.23% interest cost as they had been at the 2020 2.5% interest rate cost. This means (for those who followed our advice in 2020) if mortgage rates are around 5-6% in 2025 the borrower's ability to pay (IE percentage of disposable income) would be about the same. Is this fun? No. We hope to PAY DOWN our liabilities, releasing additional funds for other things besides mortgage payments. On the other hand this told us at the time an increase in the mortgage cost to 6% would not dramatically increase the **risk to lender** for that borrower. This means Canadian Banks shouldn't get into deep trouble from this particular risk. They might find other ways to do so.

When you feel good about the market..SELL. When you feel bad BUY

- **Steve Forbes**

At this writing the S&P500 is down **-19%** from the Jan/2022 peak. Canada's S&P/TSX Composite had declined a most sedate -8.6% from its April/2022 peak. Any way we look at it, stocks are not expensive. **This is a poor time to sell.**

March 17, 2023

Happy Saint Patrick's Day!

Have a Great Weekend

Steve & Anna Hilberry

FOR THE RECORD March 17, 2023

DOW INDUSTRIALS:	31,875
S&P 500:	3,917
S&P/TSX COMP:	19380
WTI:	$66.84
LOONIE IN $USD:	$0.7277 $US

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