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Here are our current thoughts and answers to common questions regarding the sudden collapse of Silicon Valley Bank (SVB). **Federal regulators also just announced they will make all insured and uninsured depositors whole this Monday.**

Is my cash safe at Sentinel?

At Sentinel, we do not take deposits and invest them for our balance sheet like a traditional bank or SVB. All deposits are in the form of investment accounts and all cash in these accounts by default is invested in an institutional money market fund where our size delivers a reduced fee. While money market funds do not carry FDIC insurance, they are invested in highly liquid US government backed securities maturing in 13 months or less. They seek to maintain a stable net asset value of $1 per share. Unlike checking accounts often with relatively low yields, money market accounts yield north of 4%. To improve yields further, we also will often purchase short-term Treasury bills and see yields closer to 5% for six- and twelve-month bills. We never want to lose money or access to cash and take this seriously.

Is my cash safe elsewhere? Can there be contagion to other banks?

While the FDIC just announced it will make both insured and uninsured SVB depositors whole tomorrow, an important **lesson learned from 2008 is to avoid maintaining uninsured balances with any bank at all costs.** In 2008, despite an increase in the insurance limit from $100k to $250k, uninsured depositors still saw losses of 28% imposed. This has improved since, but investors should never lose value on or access to their operating cash. **If you have operating cash with a retail bank above the insured limits in checking or savings accounts, we can help review and minimize that immediately.**

As noted below in more detail, SVB was in a league of its own in terms of risk. Its balance sheet growth, retail deposit share, portfolio size and mix, and unrealized losses on this portfolio against its required regulatory capital were all far from industry standard. We've been reviewing 2022 financials for our counterparty banks and find most to have Tier 1 Capital Ratios (which regulators focus on) adjusted for losses on their held to maturity portfolio (which they do not) of 9-13% versus just 2% for SVB. While these ranges are likely manageable and are based on the hard lessons learned from 2008, no one bank is immune to a run. Depositors broadly are also now keenly aware of uninsured deposit risk and that risk-free, liquid Treasury bills are offering higher yields. While regulators stepped in to backstop SVB, they may be less willing and able to do so in the future.

What just happened and why?

On Friday mid-day, the Federal Deposit Insurance Corporation which insures banking deposits up to $250k and supervises financial institutions closed Silicon Valley Bank (SVB). After some initial

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confusion and concerns on uninsured depositor losses, regulators just announced all depositors will have access to all of their money beginning tomorrow.

With $209B of assets, Silicon Valley Bank was the 16th largest bank in the US and is the second largest bank failure after Washington Mutual's in 2008. SVB was founded in 1983 and as its name implies it catered to the venture capital community which has grown remarkably since the 1980s and recently fueled in part by cheap, easy money.

Amongst banks, SVB was in a world of its own in terms of its pace of growth, its ultra-low reliance on stickier deposits from smaller, retail customers, and in its willingness to invest these hot deposits fully in more volatile securities. SVB's deposits, largely from the venture community, boomed during the 2020-21 tech bull market rising 86% in 2021 and peaking at $198B in early 2022. In that two-year period, its balance sheet grew roughly 250%, well above industry norms.

To earn a return on these deposits in a low-yield world, SVB poured this money into longer duration US Treasurys and government-sponsored mortgages. From 2020 to 2022, SVB's security portfolio grew from $48B to $117B. Surprisingly and despite the volatility of their deposits, the securities it held available for sale and exposed to reporting mark to market losses shrank from $30.9B to $28.6B. Seeking extra yield, SVB invested the bulk of their balance sheet in higher yielding, more volatile, long duration bonds they hoped to "hold to maturity". This category, which is not marked to market for reporting purposes, grew from $16.5B to $91.3B from 2020 to 2022.

This created a classic asset liability mismatch and SVB faced pressured on both sides in 2022 and now into 2023. SVB's assets heavily invested in longer duration, volatile bonds suffered one of their worst years in history as the Federal Reserve pushed up interest rates and bond investors worried about inflation. While SVB reported their 2022 "held to maturity" assets at $91B, their fair market value sat at just $76B implying an unrealized and unreported $15B loss. So long as SVB's deposits were sticky, SVB could truly hold these securities to maturity and avoid reporting any mark to market losses. However, if these bonds were sold, losses would essentially wipe out SVB's capital required by banking regulators. SVB's liabilities were not sticky however and were to venture firms with volatile cash flows who could demand or transfer their assets presumably at market prices in an instant. In 2022 the economy slowed, interest rates rose and liquidity dried up. Venture deposits turned to withdrawals as new financing rounds at higher valuations slowed rapidly and companies burned through cash. Rising interest rates also caused depositors to seek higher yield elsewhere. SVB offered only 0.6% more on deposits versus its arguably less risky peers and these peers still generally offer much less than "risk-free" US Treasury bills. SVB's deposits declined to $173B by the end of 2022. Remarkably, $152B of these deposits were above the $250k FDIC limit and thus uninsured.

Withdrawals from the bank continued into 2023 and last week SVB announced it was seeking to raise $2.25B of capital to shore up a $1.8B loss taken on liquidating their entire available for sale portfolio to meet customer withdrawals. This also put their held to maturity portfolio and thus the firm at risk and the stock fell 60%. Prominent venture firms advised their portfolio companies to pull money from SVB and a bank run ensued. Markets sold off broadly with many worrying about contagion and recalling 2008.

What are the knock-on effects, potential outcomes, and impact for the markets?

We are already seeing the knock-on effects. Since SVB's announcement, US stocks fell over 3%. Regional banks lost 12% with those with similarities to SVB down closer to 30%. Areas like biotech deemed to potentially have uninsured deposits at SVB fell 7%. News feeds were flooded with firms announcing their exposure with Roku announcing it had $457mm of uninsured deposits with SVB. Crypto investors, already reeling from a similar run on Silvergate, were stung further as Circle announced that it had $3.3B tied of assets backing its stable coin meant to mimic money market funds.

Most at risk appear to be venture capital firms, their capital calls, and their portfolio companies all with uninsured deposits with SVB. We've been in touch with our venture and private equity firms and most took steps to diversify and minimize their exposure, but the situation is evolving and we are all monitoring it closely.

As noted above, Secretary Yellen is concerned, just made whole all depositors, and an auction for SVB is underway with bids due this evening. SVB customer base is attractive to potential acquirers and regulators and potential acquirers were incentivized to calm jittery depositors immediately.

In conclusion, absent a messy and drawn-out handling of customer uninsured deposits, we think the SVB selloff will likely represent more of a buying opportunity than a cause for panic. Our financial bank manager, who focuses on the space and avoided both Silvergate and SVB recently with hedges in place to protect against this broader risk, recently turned more optimistic. Small and medium cap US equities are approaching the type of yield that attracted us late last September. Investor pessimism is also creeping up. We are also seeing some inflation concerns rolling off with bonds rallying strongly given this news. **As always, we would again advise all of our clients to minimize operational cash balances to FDIC insured limits and we stand by to assist.**

decision, you should carefully review offering materials and related information for specific risk and other important information regarding an investment in that type of fund.

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