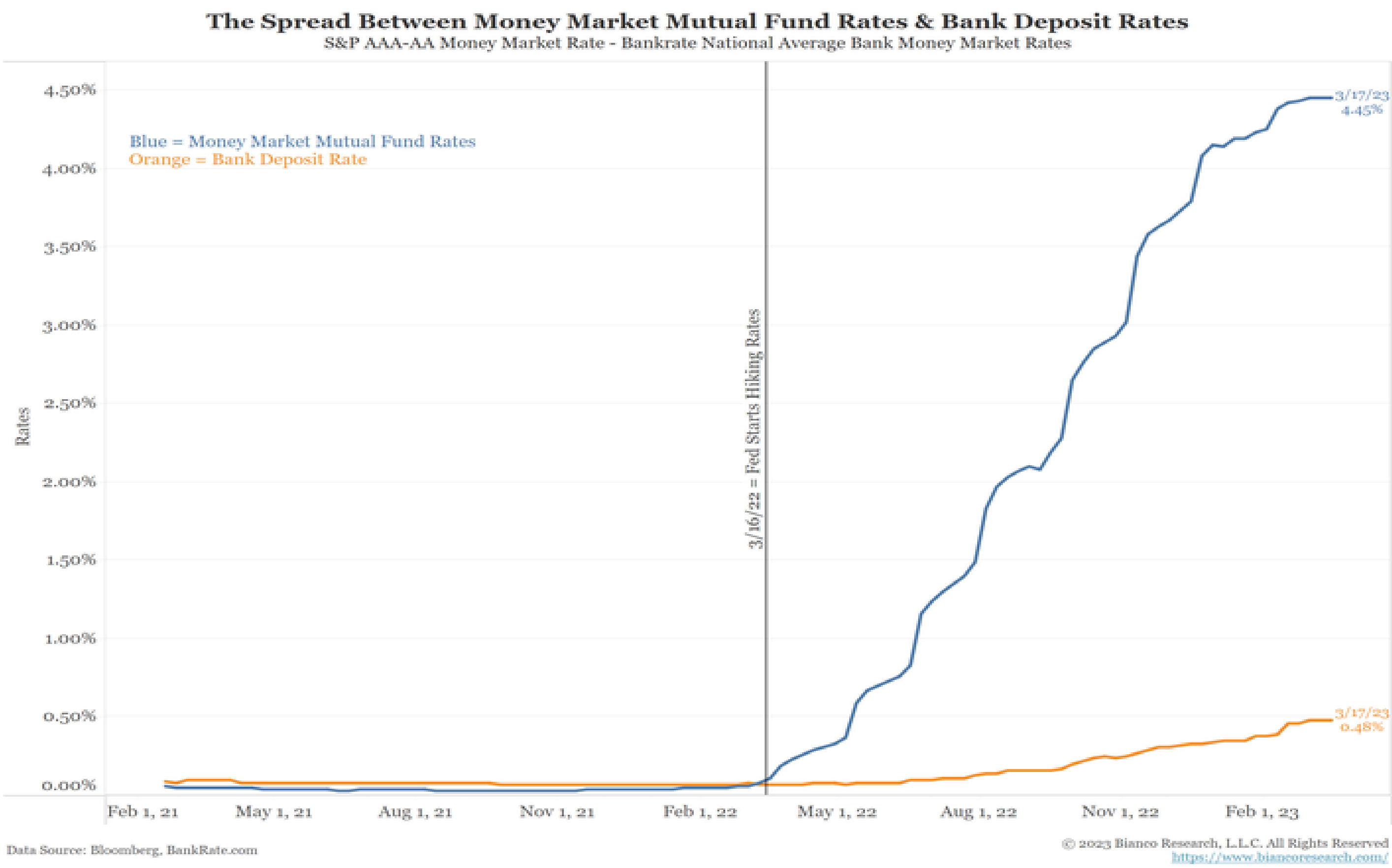
Stating the obvious, banks have a problem. Perhaps less obvious, we think the market is focused on the less material risk. Banks failing is clearly a bad sign for the economy. What concerns us most is what we believe is likely to come next.

First off, we have not seen banks with issues on the Liability (Deposits) side of the ledger for over 100 years (i.e. the Great Depression). In summary, that is what the most recent failed/failing banks (SVB, First Republic, PacWest) are dealing with. To be clear, we think the government (Fed, FDIC, FHLB) will ultimately, and necessarily step in to protect deposits. HOWEVER, that is just problem number #1.

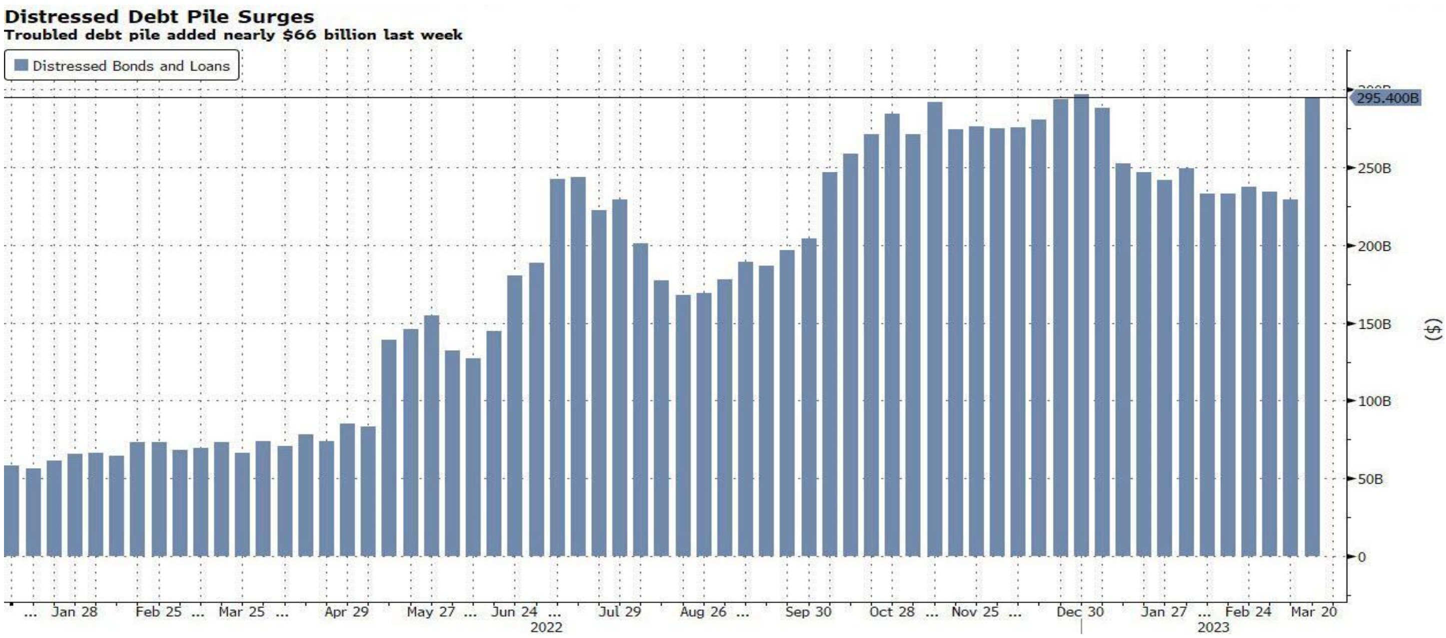
Problem #2 – we believe this event will prompt folks to look at their own checking/savings accounts, and then realize that the interest rate they are being paid on their deposits is way too low. The vast majority of banks are paying 1% or less at the moment – with a 5% Fed Funds rate. We believe that to stave off more deposits leaving, those banks will need to raise those interest rates, which dramatically reduces their profitability (Net Interest Margin).



Problem #3 – this is all happening as demand for loans is falling (higher rates, rising credit standards and more uncertainty), so those same banks are going to have a very difficult time offsetting rising deposit costs with higher rates on new loans issued.

Problem #4 - we haven't even gotten to the Asset (Loans) side of the balance sheet yet, which is what causes most banks to fail (e.g. the Great Financial Crisis). If we are in a recession, or heading for a recession, we will almost certainly see a rise in defaults on loans, which banks will need to recognize as losses and/or increase their reserves for future losses.

BALLAST
ASSET MANAGEMENT



Source: Zero Hedge, Bloomberg

Problem #5 – we do not believe there is any political appetite to save the equity/bond holders of banks. Just like with SVB and Credit Suisse, the depositors are fine, the loans still exist, and the investment securities can simply be held to maturity, but the equity and bond holders were wiped out.

"*Shareholders and debtholders of the failed banks are not being protected by the government*."

- Janet Yellen, March 22, 2023

The SVB/First Republic situations are not our primary concern. We are focused on Problems 2-5. With the liquidity provided by the Fed, FHLB and FDIC, banks will likely be able to access the loans they need to back-fill any lost deposits, albeit at dramatically higher interest costs than they were paying on deposits. The culmination of rising deposit costs, lower loan growth, increased losses on loans and with higher reserves for future losses worries us most.