



TALL OAK
CAPITAL ADVISORS

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TALL OAK UPDATE: NAVIGATING MARKET VOLATILITY

SILICON VALLEY BANK'S CHALLENGES AND SPILLOVER EFFECTS

What's happened so far?

Currently, the banking industry is facing a liquidity crisis as a result of the collapse of Silicon Valley Bank (SVB). The culprit - asset/liability mismatch. SVB, which caters to start-ups and venture capitalists in Silicon Valley, experienced rapid growth with a staggering 86% increase in deposits in 2021, peaking at around \$200bn in mid-2022. All banking operations, whether they are big or small, are centered around spreads, where banks pay low-interest rates on deposits and lend out at higher rates. SVB's excess capital was invested in long-duration bonds, mostly U.S. Treasuries. When SVB was faced with a wave of deposit withdrawal requests, they were forced to sell their long-duration bonds at a loss due to the rapid increase in interest rates over the last year. These losses depleted SVB's reserves. The bank attempted to raise capital in the markets, which was unsuccessful. As a result, more depositors began to ask for their money back, exacerbating the liquidity problem faced by SVB.

With the liquidity problem intensifying, smaller banks across the U.S. started seeing deposit outflows.

Signature Bank in New York, which was one of the largest serving cryptocurrency firms, was also closed and was taken over by the regulators. Fears that First Republic Bank would be next, caused its share price to plummet before the biggest U.S. banks stepped in to discuss joint rescue of the beleaguered lender.

Are we facing a 2008 financial crisis?

The Global Financial Crisis was primarily caused by a solvency problem resulting from bad loans held by various financial institutions, including insurance sold on these loans, all originating from the US housing mortgage market. As a result, banks were becoming insolvent as their balance sheets were taking huge losses on these bad loans and mortgages. This situation is different today as it is not primarily driven by insolvency concerns.

How did this impact the Tall Oak Capital Appreciation Fund?

The Tall Oak Capital Appreciation Fund does not have any exposure to the banks previously mentioned. Our portfolio has relatively low exposure to banks, and we remain underweight in this sector. The fund does have some U.S. Regional Bank exposure through Zions Bank and Wintrust Financial. We are confident that the customer base of these two regionals differs significantly from the previously discussed banks. Our two holdings demonstrate a higher level of customer diversification. Moreover, their combined deposit growth over the past few years has been substantially different from that of SVB. We view the recent price weakness as an opportunity to focus on some of the industry giants, such as JP Morgan or Bank of America, as well as some of the European banks. We are committed to leveraging this opportunity to sharpen our pencils and invest wisely.

What are the long-term implications?

While this crisis is not comparable to the 2008 financial crisis, it is still a crisis in confidence and liquidity.

Regulators may be able to contain it, but the long-term costs could be significant. Backstopping the entire nation's deposit base may not necessarily prevent future issues, and it may lead to increased moral hazard unless significant changes are made to the banking system. A competitive banking industry benefits all consumers and businesses in both Canada and the US.

Since 2021, we've been cautioning about the possibility of market turbulence as investors and institutions navigate the effects of higher interest rates and reduced liquidity. Although we cannot predict the outcome of the current turmoil, we remain laser-focused on risk management both at the security and portfolio level.



To this end, we continue to maintain a defensive stance, concentrating the majority of the Fund's equity exposure to companies that exhibit high levels of free cash flow and strong balance sheets.

In our upcoming quarterly report, we will explore the banking crisis's broader implications and its potential for long-term economic impacts.

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