April 2023 **QUARTERLY COMMENTARY**

The Investment Counsel Company's Quarterly Commentary is intended to provide our perspective on current economic conditions.

What happens when depositors want their money all at once? You get SVB (Silicon Valley Bank)! To prevent a further run on banks, the Federal Reserve recently established the Bank Term Funding Program. In addition to restoring confidence in the U.S. banking system, an indirect benefit of the Program provides stability to equity and fixed income markets. Banks can access the Program to borrow by pledging eligible debt securities, such as U.S. Treasury and government agency instruments, currently held at unrealized losses, and receive full value for their collateral at one hundred cents on the dollar or par (the price at maturity). The result provides stressed banks' balance sheets with an additional $620 billion in collateral, covering the shortfall in unrealized market losses of fixed income securities caused by the Fed's repeated interest rate hikes. This strategy is similar to previous temporary moves by the Fed during the 2020 Pandemic and the 2007-2008 Global Financial Crisis. Like those prior incidents, losses to the Deposit Insurance Fund will be covered by a special assessment on banks, not taxpayers.

Although both insured and uninsured depositors of Silicon Valley Bank and Signature Bank will be protected by the government, Treasury Secretary Yellen said that not all uninsured deposits will be protected in future bank failures. Some think that her inconsistent response in comparison to that of the Fed is not credible, leading to further uncertainty. At year-end 2022, total insured deposits were $101 trillion of the $178 trillion total domestic deposits at FDIC-insured financial institutions. Deposit insurance currently has the capacity to cover $128 billion. Although FDIC insurance increased during the Global Financial Crisis out of necessity from $100,000 to $250,000, proactive regulation is needed by increasing insurance to keep up with inflation and increasing deposits if a future crisis is to be averted. However, it is not up to the Federal Reserve Bank or FDIC to make new rules covering all banks. It is up to Congress. Unfortunately in 2018 Congress rolled back Dodd-Frank Reform, which was originally intended to prevent the excessive risk-taking that led to the last financial crisis.

Questions now abound not just from bank depositors, but from other investors as well. Bank runs can create extraordinary deflation, but how much? Banks are already tightening credit standards. How restrictive will credit (lending) be for consumers and businesses alike, and how much higher will the cost of borrowing become? For these reasons and more, economic growth is expected to be slower. Will Main Street feel the discomfort that Wall Street felt a year ago? The U.S. stock market dropped 26% in 2022 from January to Halloween (peak to trough) because many overreacted to fears of a recession that has yet to materialize. To the surprise of many investors, corporate earnings increased 6% to 7% and the economy continued to grow. So is the worst of the market behind investors since equity market prices have already reacted to the anticipated recession? Corporate earnings are now flat but not down. Even with all the bad news, the market remains resilient. The Federal Reserve's pending decision on whether to raise rates one last time in May and end its tightening policy, or to continue tightening, will influence all asset classes (stocks, bonds, real estate, and commodities). The Fed's job is now that much tougher, given the presumption that the banking crisis is an additional factor in reducing inflation.

Fortunately, fixed income markets for U.S. government, municipal, and corporate securities have begun recovering, benefiting all investors, especially bank portfolios. Interest rates have dropped for all but the shortest-term maturities. The yield for two-year U.S. Treasury notes has recently dropped from a high above 5.00% to below 4.00%. This is lower than the long-term average of 5.01% and far higher than the low of 0.105% on February 5, 2021. Some investors are puzzled about why bonds are rising in price and yields dropping when the Fed has not yet

signaled its intention to stop raising interest rates. The main reason is that many investors are not convinced that Chairman Jay Powell and the Fed will keep rates high until 2024. In other words, investors are not buying what the Fed is selling. The market believes that rates will be lower, not higher, later in the year. Given the constant uncertainty about Fed direction and the related impact on our economy, ICC retains a steadfast concentration in high-quality, less volatile fixed income instruments for all clients. Investors want bonds to go up when stocks are falling. Although not perfect, a diversified portfolio of stocks and higher credit quality bonds has not seen negative returns for stocks and bonds together 90% of the time (last year was among the 10% of the time). Under other stock market conditions, stocks and bonds move independently. Over the longer-term, both asset classes have delivered positive and competitive returns commensurate with their levels of risk.

If further declines in bond yields (not prices) prompt rising stock prices, then we can expect an economic soft landing. Although less likely, if bond yields fall in tandem with stocks, then the trend would reflect recession expectations. Regardless, if history is a guide:

- Equities tend to rise after the last Fed rate hike.
- Equities tend to rally after peaks in a recession.
- Some of the largest gains in equities occur in the early stages of a recovery.

Although equities will be tested in the months ahead, there are reasons to conclude that a bullish outcome is more likely. As financial markets climb a wall of worry, they prove more buoyant than anticipated, are predisposed to going higher over time, and continue to provide prudent investors with both the degree of appreciation and income needed to meet their financial goals. We appreciate our clients' patience, trust, and confidence in anticipation of resuming the market's long-term upward trend. As always, our goal is to provide prudent investment guidance along with the highest standard of service to our clients.

Important Disclosure Information

Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product (including the investments and/or investment strategies recommended or undertaken by The Investment Counsel Company of Nevada ("ICC"), or any non-investment related content, made reference to directly or indirectly in this commentary will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. Due to various factors, including changing market conditions and/or applicable laws, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or information contained in this commentary serves as the receipt of, or as a substitute for, personalized investment advice from ICC. Please remember to contact ICC, in writing, if there are any changes in your personal/financial situation or investment objectives for the purpose of reviewing/evaluating/revising our previous recommendations and/or services, or if you would like to impose, add, or to modify any reasonable restrictions to our investment advisory services. ICC is neither a law firm nor a certified public accounting firm and no portion of the commentary content should be construed as legal or accounting advice. A copy of the ICC's current written disclosure Brochure discussing our advisory services and fees continues to remain available upon request.