Capricorn Asset Management
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Navigating Uncertainty in the Banking Industry

Beware the Ides of March. This year this warning is apt.

The month was characterised by heightened scrutiny of the global banking industry. It started with stress becoming evident in the USA. Several bank names popped into the headlines for all the wrong reasons. Suddenly lesser known names such as Silvergate, Signature, Silicon Valley Bank (SVB) and First Republic joined their more renowned compatriots such as Credit Suisse and Deutsche Bank in the spotlight.

Every bank has its own unique circumstances and balance sheet characteristics, defined by the nature of the markets they choose to operate in. For example:

- Silvergate was known as a cryptocurrency and fintech player, best known for its "Silvergate Exchange Network" which had all the major cryptocurrency exchanges as its customers.
- Silicon Valley Bank is active among start-ups, venture capitalists and private equity.
- First Republic focuses on high net worth individuals and their businesses, such as Mark Zuckerberg et al.

However, in our view, the common denominator in all cases is the sharp increase in interest rates driven by the Fed since early 2022.

Within a period of twelve months the Fed Fund Rate was lifted from 0.25% to 5.0%, the steepest and largest increase in living memory. From the outset of its tightening campaign, we warned that Fed hiking cycles usually lead to choppy markets. Little did we anticipate that US equities will be down 25% and the 10-year Treasury yield will be down 20% at some point during the year. Obviously, other factors also played a role, such as the Ukraine war.

The fact of the matter remains that banks suffered big losses on their Treasury holdings, albeit unrealised at first, until it became evident when they were forced to sell these assets to fund deposit outflows. These outflows in the case of SVB were the result of its clients' venture capital, start-ups, private equity and initial public offering type of business models coming under immense pressure due to the surge in funding cost, as a result of interest rates driven upwards by the Fed.

Therefore, deposit outflows led to forced asset sales, which resulted in losses, then the need to raise capital, which led to a confidence shock to investors that pulled back, as well as a confidence shock to depositors, thus causing a "run on the bank", which ultimately resulted in SVB entering receivership with the Federal Deposit Insurance Corporation (FDIC). In such a case, the FDIC takes control of the bank and oversees its liquidation or sale.

SVB is being sold to First Citizens Bank which will take on assets of $110bn, deposits of $56bn and loans of $72bn. It occurs at a loss to the FDIC of $20bn. However, $90bn worth of assets remains in receivership and will be sold in a more orderly fashion by the FDIC. Signature is being sold to New York Community Bancorp from FDIC receivership at a loss of $2.5bn. First Republic appears to have survived as a going concern in the wake of deposits of around $30bn that were made with it by a grouping of large banks, led by JP Morgan. Scandal plagued Credit Suisse was taken over by UBS, while the market's cross-hairs appear to have moved on from Deutsche Bank. Lastely, Silvergate will be wound down.

Naturally, these details regarding who will be saved and who will fail and how big the losses are and who will bear them, had people harking back to the Great Credit Crisis (GCC) of 2008, also known as the "sub-prime" crisis. This crisis also started in seemingly far-flung corners of the global financial system that appeared to be unrelated. In the end, the failure of the 150 year old Lehman Brothers, the 4th largest US investment bank, became the headline, signature event of the crisis. It all boiled down to reckless lending in the real estate markets. When the tide turned, it led to a gargantuan credit crunch.

In the wake of that crisis, laws and regulations were brought in in order to attempt to create a healthier banking system as well as to constrain the size of these institutions from becoming "too big to fail". Not that size protects against failure, it is perhaps more accurate to say, "too big to let fail". These big banks are now euphemistically called systemically important banks, or SIB's. Morally and ethically, Credit Suisse should have been allowed to fail. However, the sheer size of the balance sheet, the size of the potential losses, the number of people involved as well as the contagion that will flare up across the global financial system at great cost to the global economy, led the Swiss to save it through a forced takeover.

The SIB's in the USA are much more rigorously regulated than the second and third tier regional banks, such as the ones discussed above. Therefore, one trusts that the likes of JP Morgan, Wells Fargo, Bank of America, Citi, Goldman Sachs and Morgan Stanley will not be allowed to become the next "Lehman" moment that sparks a global crisis similar to the one in 2008.

Closer to home the South African and Namibian banking system has proven to be well-regulated, well-capitalised, well-managed and an analyses of the balance sheets shows that our top tier banks' exposure to for example held-to-maturity bonds, which is not continuously valued against prevailing market prices, are very small as are the other event risks that we've witnessed abroad. The fact of the matter is that banks once again came into the spotlight for all the wrong reasons which is a trend we could expect to see more of internationally as contagion risks will especially impact the smaller less well-regulated banks in the US and overdemand to top tier bank paper and US treasurers is expected to continue for the time being.

The importance of ongoing Enhanced Due Diligence and Reverification

Client Reverification is an important practice in the investment industry for several reasons:

1. **To comply with regulations**
   In Namibia, as in many other countries, financial institutions are required to comply with various regulations and laws designed to combat money laundering, terrorism financing, and other financial crimes. One such regulation is the Financial Intelligence Act 13 of 2012 of the Republic of Namibia, which requires Capricorn Asset Management (CAM), as a financial institution, to conduct ongoing due diligence and to periodically reverify the identity of our clients. Failure to comply with these regulations may result in fines, legal penalties or reputational damage.

2. **Risk management**
   Verifying the identity of clients is an important part of managing risk in the investment industry. By verifying the identity of clients, financial institutions can ensure that they are dealing with legitimate clients who are not using false identities to engage in illegal activities such as fraud or money laundering.

3. **Updating client information**
   Reverification allows financial institutions to continuously update their records with any changes in their clients' information, such as a change of address or contact details. This ensures that they can communicate with their clients as needed and can continue to provide quality service.

4. **Protecting the institution and the client**
   Reverification helps protect both the financial institution and the client from fraud and identity theft. By ensuring that the client's identity is accurate and up to date, the institution can avoid inadvertently releasing sensitive information to fraudsters or scammers who may be using false identities to gain access to accounts.

CAM, as an accountable institution continuously review and re-verifies our clients' information. We therefore humbly request your co-operation with regards to client information requests. This will aid in keeping your accounts with us in compliance with the Act and thus making transacting more efficient.

Please keep an eye out for any reverification requests. Should you have any questions, please contact us at cam.reverification@capricorn.com.na

You may be contacted by our office to supply us with the relevant documents regarding the reverification process.

Only submit these documents via the following means:

- cam.reverification@capricorn.com.na
- Our offices
- At any Bank Windhoek branch for the Attention: Capricorn Asset Management

Introducing the Class of 2035

As we all know the first years of our academic career set the tone that echoes through the rest of our life, as it forms the foundation on which we build our careers and mould our lives. The success of this stage depends on numerous factors, often out of one's control. Whereas the one thing that we can control is our attitude, because with the right attitude, your opportunities could be endless.

Here at Capricorn Asset Management, we understand the importance of having the right attitude and for this very reason, we started our Class of 20XX program with the aim of giving young Namibian learners a positive start to their academic careers through the donation of brand new school uniforms, as the saying goes, "if you look good, you feel good".

This year, with the help of Anusa, a project that stems from Beautiful Kidz, we were able to reach 21 schools and provide uniforms to 304 less fortunate Namibian school children.

"The smiles on the children's faces after trying on their new uniforms for the first time truly shows how something so overlooked by most of us can mean so much to those that need it." **– Daniel Gresse (CAM employee)**