RE: **INVESTMENT COMMENTARY FOR PERIOD ENDING MARCH 31, 2023**

FROM: **ARGENT CAPITAL MANAGEMENT**

DATE: **APRIL 20, 2023**

"Only when the tide goes out do you discover who has been swimming naked."
- Warren Buffett

Every few years a financial crisis arises that brings to mind this famous Warren Buffett quote. The trigger this time was Silicon Valley Bank – until recently a media darling, whose success has now been exposed as being built on imprudent low interest rate bets and a massive overexposure to the venture capital and technology industries. It was a strategy that worked brilliantly . . . until it didn't. Once the economy cooled, clients began making significant withdrawals from their accounts. In order to meet the cash demand, the bank needed to sell bonds in its portfolio. This is when the problem arose, as Silicon Valley Bank had bought very long-term bonds to squeeze extra returns at a time of very low interest rates. Given the jump in interest rates, however, those bonds were now priced at a huge discount to face value. In other words, Silicon Valley Bank was sitting on billions of dollars of unrealized losses that needed to be realized. As word spread of the significance of the losses, a classic "run on the bank" began, and Silicon Valley Bank had nowhere to hide, except via a government takeover.

Initial fears of *contagion*, meaning a run on for others within the banking sector, have proven to be unwarranted. While the economic impact so far has been negligible, there is no doubt that ramifications from the debacle will have a somewhat chilling effect on the markets for a time. Events like this undermine confidence in the economy. Nonetheless, March ended on a positive note with market rallies that carried most stock and bond indices into positive territory for the quarter, a welcome turnaround after the widespread underperformance of stocks, bonds and real estate in 2022. The rally in equities has been narrow, however, and the average stock is up less than one percent year-to-date.


"I'm an optimist. I'm convinced that everything is going to go to hell, but not for a while yet."

Notwithstanding banking concerns, the big story for investors remains *inflation*, which persists at uncomfortably high levels. Getting a handle on inflation is a challenge, as actions by the Fed take quarters, or even years, to have full impact. Thus, the Fed is in the difficult position of trying not to do *too much* in raising interest rates, while also not doing *too little*. Unfortunately, their efforts will be complicated, in all likelihood, with debt ceiling debates this spring, which will likely peak in June. Lawmakers will need – despite all their protestations to the contrary – to compromise and suspend or raise the debt ceiling limits. The fact that this needs to happen is not debatable, and it is hardly the first time it has been necessary. Since 1960, Congress has acted no less than seventy-eight times (!) to revise the debt limit, notably under both Democratic and Republican administrations. The one time the debt ceiling was pushed to the absolute limit was in 2011, and that ended badly, with significant consternation experienced by the markets, and a downgrade of the rating of US Treasury debt.

"Actually, these aren't bad times to be delusional."

Looking to the markets today and the data that supports it, investors will note that while times are still relatively good, a lot of headwinds are building. The banking crisis may be limited, but it is still a big deal. In addition, money supply indicators have shrunk dramatically, usually the sign of an economic slowdown. Housing prices began their decline in the fall of 2022, and the downward trend has continued for seven consecutive months. All of this, of course, is heavily influenced by the big jump in interest rates, as the Fed has raised rates over the past year from near zero to 4.75 percent. As a result, the yield curve is significantly inverted, meaning short-term interest rates are higher than long-term rates. That is not a good sign. In addition, oil prices, while down from their peak, are high, and corporate earnings have been flattish-to-down the past several months. All this provides ample evidence that a recession likely looms in the future. Given this, our hope is that the Fed puts a pause on additional interest rate increases for a time to allow their prior actions, as they say, to work their way through the python.

Clients frequently mention to us how troubled recent years seem. They do, of course. However, as we have noted before, when have they not? There are few times in American and World history when there was not social upheaval, armed conflict, economic turbulence and political divide. Through it all, patient investors in quality companies and diversified portfolios have experienced outstanding returns relative to inflation or other investment options. While current market troubles could last for several more quarters, we continue to find lots of great companies at reasonable prices in which to invest. That is exciting because markets usually turn long before positive news is reported.