Abner Herrman & Brock
asset management

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"History does not repeat itself, but it often rhymes." Mark Twain

The 2023 collapse of two US regional banks, albeit under different circumstances, certainly rhymes with the financial crisis of 2008. In its broadest scope, the behavior is similar; the banks in question took higher investment risk to achieve above average returns without proper risk measurements, thereby jeopardizing their customers' livelihoods. Despite the increase in bank regulations implemented after the 2008 crisis, the banks failed, and the US government was in the uncomfortable position, once again, to provide a backstop to the banks' depositors. The government's guarantee of deposits allowed capital markets to stabilize. The silver lining of this crisis is its potential to assist the Federal Reserve in its fight against inflation. The unrealized losses in the bank investment portfolios, and the higher scrutiny from both investors and regulators, will likely slow lending by many small and mid-sized banks. Lending is a key driver of economic growth, and its slowdown may help to slow the rate of inflation.

The primary concern of investors during the quarter was the elevated rate of inflation. Fortunately, the inflation rate has continued to decline. The annual rate in February was 6.0%, the lowest level since its peak last June of 9.1%. And yet, 6% is significantly higher than the 2% Fed target for inflation. The Fed raised rates again by 25 basis points in March. Since then, the labor market, which has been robust, showed signs of moderating. Job openings fell below 10 million for the first time since May 2021 and US average hourly earnings growth drop from a high of 5.7% to 4.4%. If the trends for inflation and the economy continue to show a slowdown, the Federal Reserve may consider a pause soon.

Custom Balanced and Core Equity portfolios are positioned to anticipate an environment that may be closer to a near term peak in interest rates coupled with more moderate economic growth. Client portfolios did not have exposure to the banks that collapsed, nor other regional banks. Furthermore, both Balanced and Core Equity strategies are comprised of large capitalization companies that have operational depth and breadth providing risk mitigation in times of crises as compared with small and mid-size companies. The positions held by the portfolios in the larger banks are opportunistic investments. The larger banks are gaining market share as a large amount of new deposits and loan activity shift from the regional banks. Sector emphasis includes Healthcare, Financial Services, and Industrials.

Client Bond portfolio reinvestments have been executed at the highest returns since 2010. The yield curve, although still inverted, is in the process of normalizing. We have slightly increased the duration of the bond strategies to secure ample returns for a longer period. For those in the highest tax brackets, municipal bonds offer a particularly attractive return. Both Taxable and Municipal bond strategies have more recently attracted those investors who have been waiting for rates to rise.

AHB continues to monitor the changes and concerns about the commercial real estate market, effects of the debt ceiling debate, geopolitical uncertainty, and the resiliency of the US consumer. Please do not hesitate to contact our team if we can help with any further questions or concerns.

Wishing you good health and a pleasant Spring season.

The AHB Investment Team