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Neuberger Berman Fixed Income

Update on SVB Financial Group — Tuesday, March 14, 2023

Summary

While the situation with Silicon Valley Bank remains volatile and uncertain, with facts continuing to unfold, the Fixed Income team has released an initial blog with thoughts from the team:

The past three days have seen some remarkable movements in fixed income yields and spreads. This is a fast moving situation but we wanted to highlight some key views.

- *This is unlikely to be a banking crisis like 2008. The issues today are not systemic bad assets and loan-book credit issues across the banking system. While loan-quality issues will likely rise over time, the issues we are seeing today are more akin to a traditional "bank run" where investor psychology is playing the leading role, which is partly being driven by price declines on high quality assets (such as Treasuries and agency mortgages) because of the Fed tightening cycle. Ultimately, we believe that it should be easier than in 2008 to restore confidence given the fundamentals of the U.S. banking system remain solid.*

- *The Fed/Treasury/FDIC joint actions over the past weekend are important. It is now apparent that they will allow banks with liquid assets to get liquidity and funding, with no haircut and with relatively attractive funding rates. This should allow banks with portfolios of liquid assets to have a backstop of funding if deposits continue to leave. That said, for banks which have larger loan books or fewer holdings of securities, this tool is less relevant. Will this action be sufficient to change investor psychology? That is less clear, but it's important to remember that if often takes policy makers a couple of attempts to find a solution to these types of issues. More actions will likely come if these moves prove to be insufficient.*

- *Importantly, the Fed will likely get a durable tightening of financial conditions. Unlike last year, where much of the financial conditions was driven by stock, bond, and dollar movements that were often reversed, banks likely will be changing their behavior in the coming quarters. Less lending and more capital preservation by banks is expected in the near future. For a more detailed view on what's happened to the banking system, and what comes next, please see our recent Insights piece. The Fed is looking at a rapidly changed backdrop in which expectations for growth and inflation should be coming down. We have been expecting the Fed's hiking cycle to end this spring as inflation plateaus, and the events of the last few days reinforce that view.*

- *We expect many of the fixed income themes we've been emphasizing to continue to play out. We believe investors should remain focused on positioning "up in quality," both within and across sectors, intermediate term rates that will be peaking and more rangebound, and yield curves that can begin to steepen. We expect the coming days and weeks should bring some opportunities in spread sectors.*

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In addition, please some further detailed comments below from our Fixed Income team:

Background of Current Issue

On 8th March 2023, SVB Financial Group (SVB) announced the disposal of its available-for-sale (AFS) securities at a loss, an intent to raise capital to offset the loss, and a planned repositioning of other aspects of its balance sheet.

The actions by the company were intended to bolster its balance sheet and to better position for the interest rate environment as well as anticipated ongoing deposit outflows. However, the capital raise was unsuccessful, and the announcement also resulted in a sudden, unmanageable degree of deposit outflows which ultimately led to receivership by the FDIC for Silicon Valley Bank (SVB Financial Group's bank subsidiary).

SVB Financial Group, which is the issuer of senior unsecured debt common and preferred stock, has not yet filed bankruptcy and, at least for the time being, appears to be pursuing strategic alternatives including the possible sale of certain operations and assets even though bankruptcy remains possible eventually.

US Government Response

Considering SVB Financial and the subsequent closing of Signature Bank, the Treasury, Federal Reserve and FDIC jointly announced that it will make available additional funding to eligible depository institutions to help assure banks have the ability to meet the needs of their depositors.

This program effectively backstopped both insured and uninsured deposits by allowing banks to obtain funding through the creation of a new Bank Term Funding Program (BTFP) with banks pledging various qualifying assets as collateral without having to sell these securities to raise capital in a time of stress. The program seems to address the potential for a larger systemic problem following the failure of SVB and SBNY.

Broader Financial Sector Implications and Government Implications

While we are still of the view this event was an idiosyncratic event given the nuances of SVB and its unique deposit base and business model, the last few days have created a second problem; a crisis in broad confidence of the financial sector and related deposits.

We saw over the weekend the Treasury, Federal Reserve and FDIC jointly stepped in to protect depositors by announcing that all deposits from SVB and SBNY (insured and uninsured) will be protected and deposits will be available beginning on Monday, March 13th. In addition, it was also announced a longer-term Bank Term Funding Program also designed to help the financial sector with liquidity related loans.

Given this backdrop and the fall in confidence we have seen, it is also important to differentiate this episode compared to typical, systemic banking concerns.

These systemic banking concerns usually occur, in our view, when there is uncertainty surrounding how to value loans or securities on bank balance sheets; consider the 2008 Global Financial Crisis as a good example of this. In the current situation, the only assets that have really declined in value are liquid and well understood by markets – US Treasuries and Agency Mortgages primarily.

While, ultimately, banking requires some base confidence from investors to properly function, we think the strength that exists through the banking system should prevent meaningful contagion and shore up this confidence. That said, we expect continued volatility in the short-term as the second order effects from this episode play out.

In addition, we believe the intervention by the Fed is likely to be one of many, but we are confident that ultimately the Fed and regulators will prevent systemic damage to the regional banking sector.

Outlook and Managing the Name Going Forward

While we view these events as isolated and the exposures remain small across the Fixed Income platform.

Volatility remains in the broader sector, namely in regional banks across the United States. However, we do not currently see this as an opportunity to add risk and remain focused on underwriting existing holdings as the situation unfolds.

The situation regarding SIVB and SBNY have increased the awareness of the potential for deposit pressure to increase and for margins to contract across the banking industry. Overall, while under pressure, we expect the global systemically important banks (GSIBs) and many regionals should be able to manage the risk given their liquidity, capitalization and diversified depository base. That said, we expect the regional banks to remain under more pressure versus the large money center banks given the overall crisis of confidence in the market.

While the direct exposure in the Fixed Income sector is primarily within the Investment Grade markets, please find below additional comments from the Non-Investment Grade, Emerging Markets Debt and Municipals teams.

Thoughts from the Non-Investment Grade Team

Across our High Yield and Bank Loan strategies, the platform does not own direct exposure to Silicon Valley Bank or Signature Bank bonds or preferred securities. We also do not have exposure to small regional banks across the platform. Our High Yield strategies have current exposure to larger national banking chains which we view generally as better capitalized with more diverse deposit bases. Our Bank Loan strategies currently have no exposure to banks whatsoever. We have not identified issuers in our portfolios with material direct exposure to the banks at this time, and our team remains focused on seeking to identify any potential indirect and or idiosyncratic implications.

We think the most meaningful impact on the Non-IG markets and portfolios will be how this event will impact the overall macro environment and risk sentiment generally, as opposed to an idiosyncratic issue with credits owned in our portfolios. This is a developing situation and we will keep our clients informed of our views on a timely basis. Please reach out to your NB sales representative if you have any further questions.

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Thoughts from the Emerging Market Debt (EMD) team

While there is no direct exposure to either SVB or SBNY in the EMD markets, spreads have been widening in EM generally alongside the broader equity and credit markets. This is likely both a function of credit risk-aversion as well as an inability of credit markets to keep up with the subsequent sharp rally in US-Treasuries.

EM FX is showing a mixed picture, with expectations of an easier Fed on the back of recent events weakening the USD; however, this is paired off by risk unwinds in EM FX too which is pushing EM FX in different directions. For example Asian currencies generally have performed well. In local bond markets, we are seeing rates that have gone lower but mostly in lower risk countries and less so in higher risk/higher yielding markets.

Thoughts from the Municipals team

The municipal bond market has no direct exposure to SVB or SBNY.

Given its high quality nature generally and safe haven reputation, high quality tax-exempt municipals have seen solid demand over the last two trading days. We think investors will be cautious on adding to the riskier segments of the market until volatility subsides.

Going forward, we are closely monitoring market liquidity particularly as it relates to some of the market's regional dealers. In addition, we are looking to see if some regional banks attempt to sell a portion of their municipal bond holdings and whether that puts any pressure on secondary markets.

Fixed Income Platform Exposures

Direct Exposures:

Direct SIVB exposures in public market commingled funds are provided below (fund-level direct exposures as of the close of business on March 8th):

- *Neuberger Berman Strategic Income Fund (Mutual Fund): 0.15%*
- *Neuberger Berman Strategic Income Fund (UCITS): 0.14%*
- *Neuberger Berman Global Investment Grade Credit Fund (UCITS): 0.40%*
- *Neuberger Berman Strategic Multi-Sector Fixed Income Trust (CIT): 0.12%*
- *Neuberger Berman Multi Asset Income Fund (UCITS): 0.35%*
- *Neuberger Berman Core Plus Trust (CIT): 0.07%*

If not listed above, there is no direct exposure.

Secondary Exposures:

We do not have any exposure to Signature, First Republic, Pacific West and Silvergate across the Fixed Income platform.

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Please also see the NB website for further details on exposures at the following link: UCITS Funds | Neuberger Berman (nb.com)

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