# Quarterly Letter March 2023

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THALASSA CAPITAL LLC

*"Banking is necessary. Banks are not." – Bill Gates*

Multibillionaire Bill Gates is probably right in his assessment of the future role of banks in the economic fabric but in the short-term, banks still retain a systemic profile.

We were rudely reminded of that a couple of weeks ago when a bank run started on Silicon Valley Bank, a niche player in servicing the startup ecosystem in Northern California.

Most of the times, starting a bank run is irrational but once it starts it certainly makes sense to join in. The leveraged nature of banks incentivizes that behavior unless institutions act swiftly to backstop liquidity crises and panics, which is exactly what happened in response to the SVB's fiasco. Unfortunately, backstopping is a short term measure which is not going to change neither the long term trend of less relevance for banks in the intermediation process nor the trend toward more consolidation of domestic banking institutions.

In the United States we still have more than 4000 banks and the top ten on the list control only around 50% of assets. This is in contrast with the rest of the world where a handful of banks control most assets. Normally, more competition is a good thing but in the case of a globalized economy and leveraged money centers, size is good. There is an intrinsic subsidy to large money center because of their systemic profile.

From an investor's perspective, this recent turmoil may open the door to opportunities in some of the largest banking franchises. However, the recent events also create additional issues. The most important element to analyze is the future course of monetary policy.

Banking instability raises financial frictions and slows down lending which in turn has a cooling effect on the economy. The yield curve is steepening its inversion indicating a

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higher probability of a recession and the need for the Fed to stop raising rates and perhaps to start decreasing them before the end of the year.

If that were to be the case, bonds will increasingly be attractive (a call we made at the end of 2022) along with defensive equities. However, more friendly monetary policy may not necessarily help at first more aggressive equity sectors because their earnings expectations seem to still be too high given a higher probability of a recessionary period.

We continue to believe that a cautious stance is required in the short term but, as stated in our previous missive, eventually opportunities will arise in secular long term trends reflecting major structural changes in our economy.

As always, we would like to thank you for the renewed confidence in our work,

Youri Bujko

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