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Commentary

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International: Did we not learn anything from the 2008 financial crisis?

In brief

Perhaps I am naïve, but I am almost certain that, prior to February 2023, I had never heard of Silicon Valley Bank (SVB).[1] The first time I became cognitively aware of SVB was in early 2023, when many of my venture-capital friends in Israel started moving money out of the country in response to the Israeli government's proposed court overhaul that would give the government a larger voice in the selection of judges while limiting the Supreme Court's power to strike down legislation. Many investors and companies recognized that such reform would harm democracy and the economy, and thus made the decision to move their funds abroad.[2] Unlike the anecdotal stories I had been hearing that very little money was moving from Israeli banks to Swiss banks, it was the exact opposite for SVB.[3]

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Fast forward one month, and those same people who had moved their money out of large Israeli banks were panicking, because now they could not access the funds recently moved to SVB. Just two short weeks later, SVB, one of the leading private banking names in the venture capital arena, no longer existed.[4]

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Key takeaways

The collapse of Lehman Brothers and the 2008 financial crisis occurred less than 15 years ago. How and why did the fall of SVB happen so soon thereafter? The purpose of this article is not to relitigate what happened or how the Swiss government handled the matter (or how the banking situation devolved so fast). Rather, my purpose for writing this article originated when I looked at my Swiss Third Pillar Plan and questioned why it dropped so much despite my best efforts to maintain diversification. Then, and only then, I realized that one fund was heavily invested in bank stocks, and I started pondering whether I had learned any lessons from 2008. Did the wealth management industry, particularly the wealth owners, learn anything from 2008? My conclusion is that many

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[1] SVB was formed in 1983 after co-founders Bill Biggerstaff and Robert Medearis came up with the idea during a poker game. SVB went public in 1988 and moved to Menlo Park in 1989 to establish a presence in the venture capital area. SVB nearly tripled in size between 2019 and 2022, when it rose from the 34th largest commercial bank in the US to the 16th largest. See Erin Gobler, "What Happened to Silicon Valley Bank," available at https://www.investopedia.com/what-happened-to-silicon-valley-bank-7368676.

[2] See, for example, https://www.haaretz.com/israel-news/2023-02-01/ty-article/ceo-of-multibillion-dollar-startup-to-leave-israel-over-judicial-overhaul/00000186-0bf6-d9b4-afb7-0fff39480000.

[3] On Thursday, 9 March 2023, in response to SVB's announced USD 1.8 billion loss on its bond portfolio, investors and depositors attempted to pull USD 42 billion dollars out of SVB. See https://fortune.com/2023/03/11/silicon-valley-bank-run-42-billion-attempted-withdrawals-in-one-day/. On 13 March, the Times of Israel reported that Israeli banks were able to transfer USD 1 billion from SVB to Israeli accounts before the bank was seized by government regulators. https://www.timesofisrael.com/tel-aviv-shares-drop-as-svb-failure-triggers-cash-flow-concern-for-israeli-startups/.

[4] SVB was shut down by the California Department of Financial Protection and Innovation on 10 March 2023, two days after it announced its USD 1.8 billion loss on its bond portfolio and the plans to sell common and preferred stock to raise USD 2.25 billion. The following day, the stock of SVB's parent company, SVB Financial Group, crashed upon the market's opening, and more SVB customers began withdrawing and attempting to withdraw their money (approximately USD 42 billion in attempted withdrawals). On 17 March, SVB Financial Group filed for bankruptcy. First Citizens Bank acquired SVB on March 26. See Erin Gobler, "What Happened to Silicon Valley Bank," available at https://www.investopedia.com/what-happened-to-silicon-valley-bank-7368676.

did but may have since forgotten. I also realized that significant wealth has been created since the 2008 financial crisis by wealth owners too young to appreciate and learn from the 2008 crisis.

In this article, I will discuss the impact of these two factors and recap some basic lessons that I believe will be beneficial to those wanting to be prepared in the future.

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People remember 2008 but forgot the lessons

As a 50-year-old, I clearly remember the 2008 financial crisis. I remember seeing 40% of my limited investments wiped out (granted, I did not have that much), but a very wise man advised me: pay down your debt first and invest in your pension. That advice has served me well, and, in the aftermath, my resulting net loss was less than 3% of my total wealth in 2008. I know many others who were left far worse by the 2008 crisis, and many who subsequently lost their entire wealth in Bernie Madoff's and Allen Stanford's Ponzi schemes.

By 2010, the stock market started to rise again, and, for nearly 12 years, it seemed like the market was only capable of going in one direction. Even during the height of COVID-19, when the market corrected, six months later it again soared to new highs. Did people who were old enough to have money in 2008 learn the lesson? I believe they did. Investment strategies certainly changed, but, at the same time, so did the market. Artificial intelligence/pharma/tech superseded returns on all prior assets. Cheap money was king for almost 15 years. Even if people learned the lesson, the fall of SVB was not driven by bad investments, but instead by the impact of the rising interest rates that seem more in-line with historical norms. Perhaps the decisions to steadily increase the interest rates as a mechanism to combat inflation were hastily made without considering all potential negative side effects.

The wealth owner has changed

The most significant development in the last two decades is the age at which wealth is created. Leaving aside Sam Bankman Fried and Gary Wang, co-founders of FTX, 75% of the remaining billionaires on the "10 Under 40: The Youngest Billionaires On The 2022 Forbes 400" list earned their wealth in technology and have created their wealth since 2008.[5] They were not cognizant of the 2008 financial crisis and were too young and/or inexperienced to learn the lessons. The generational shift has also made a difference as to how the younger wealth owners view the past, as well as utilize debt. Ultimately, people who made money from technology stocks and venture capital funds had never experienced high interest rates and, therefore, had no base line for comparison.

So where does this leave us?

Diversification

Diversification does not mean only the diversification of assets into different investment classes but should include the diversification of where one keeps funds. For example, many people could not move money out of SVB and other failed banks, because they did not have another account readily available into which to move the funds. One should have at least two bank accounts in each jurisdiction in which they regularly transact business, and two bank accounts in a safe-haven jurisdiction. Just to illustrate that I practice what I preach, I maintain two bank accounts in each of the US, Switzerland and Israel.

Consistent with the most commonly understood meaning of diversification - not putting all eggs in the same basket - diversification also should include diversifying currencies,[6] brokers, etc. One might consider maintaining some cash reserves in the currency of a

[5] https://www.forbes.com/sites/jemimamcevoy/2022/09/27/10-under-40-the-youngest-billionaires-on-the-2022-forbes-400/. See also https://www.businessinsider.com/meet-the-15-youngest-billionaires-in-america-forbes-2021-10?r=US&IR=T#13-ernest-garcia-iii-carvana-founder-3

[6] But see Steve Beck, "Should You Use Currencies to Diversify," https://money.usnews.com/money/blogs/the-smarter-mutual-fund-investor/2011/12/09/should-you-use-currencies-to-diversify.

safe-haven jurisdiction or a neighboring jurisdiction for advantages that go beyond hedging inflation, for example, to provide a safety net in the event of an unexpected crisis, such as what we witnessed with those fleeing Ukraine after the Russian invasion last February.

Thus, the lesson: diversify asset classes, diversify funds, diversify brokers, diversify banks, diversify banking jurisdictions, diversify currencies - diversify, diversify, diversify!

Minimize debt

Each and every time there is a financial crisis, debt is always involved. People seem to lose big (as well as make big) on debt. In the end, debt is the great multiplier, but it is also the great destroyer. Could I actually have much greater net wealth than I do today if I utilized more debt? Of course, but I choose to pay down debt as quickly as possible, because I am always fearful that I will not be able to make a mortgage payment. (It is also very interesting to see how little one actually needs to live on when there is no mortgage to pay). One should consider utilizing debt to supply only the basic necessities in life and not as a mechanism to achieve greater wealth by taking on additional risks.

Live below your means

The one repeated pattern I have seen get people into trouble is living beyond their means. And to the point illustrated above regarding minimizing debt, some even use debt to live beyond their means. That always seems to lead to bad investment behaviors.

For example, I recently witnessed someone go into default because they loved luxury living so much that when the SARON interest rate increased, they could not pay their mortgage. Just like with residences, the same rule holds true with cars and other large asset purchases. Do not try to swing a Ferrari on a Fiat budget, because you will likely be unable to do it without incurring substantial debt, in addition to the otherwise unaffordable, incidental costs of owning that asset (i.e., unaffordable maintenance, repairs, taxes, etc.). Living below your means will enable you to save money for future investments without having to incur additional risks beyond the funds invested.

Keep cash around

Having cash around provides opportunities in an economic downturn or in an unexpected emergency. However, what does cash mean? It does not necessarily always mean a fiat currency. Unless you are lucky to transact business with a bank that has every Swiss franc protected (like certain cantonal banks), you are always taking bank risk. But, if one selectively puts assets in short-term bonds, the risk shifts from bank risk to asset risk.

Additionally, keeping cash on hand enables one to plan for the possibility that their assets located in an unstable political environment might become frozen or even worthless. Yet in a world of currency controls, if one needs to run, one may not need to move funds quickly to restart. What is required is to have a few locations with money on hand to allow one to sustain oneself for an indefinite period.

Do not allow securities lending

The worst issue for average investors is not getting their assets returned. In the Lehman Brothers bankruptcy matter, the biggest issue was locating the assets that had been subject to securities lending. There are two primary risks with securities lending:

(1) borrower default risk; and (2) cash collateral reinvestment risk. Such investments are just not worth the return or the risk. Do not permit securities lending.

Upskill

One never knows where the world is going. Always learn. Develop another skill or trade. Learn another language. Make options possible to earn that are not otherwise there. I have personally observed that if one does not have the personal skills to start again, it is nearly impossible to restart from scratch, especially in another country where one lacks sufficient language skills. Preparations for children should include learning sufficient language skills and seeking an education that is portable to other jurisdictions to enable them to rebuild anew.

Multiple residences

Another lesson from the pandemic and from the Russian invasion of Ukraine is that it is not good to wait until after a crisis hits to move to another location. Find options and have them ready in advance. Personally, if my wife and I had to live locked down together in a small apartment in Zurich during the pandemic, we might not have survived. Fortunately, we have a larger apartment in the mountains that we could each visit when we needed some quiet time and isolation. As a result of the demand for second residences, property prices exploded as everyone scrambled to move to the countryside.

Supply chain risk

Make sure you have a sufficient stockpile of necessities, especially medicine, on hand to address potential supply chain disruptions. During the height of the pandemic, many observed supply chain shortages with medicine, medical equipment and other basic necessities such as toilet paper and sanitizer.

When these items became available, they were quickly hoarded by consumers who were lucky to be first in the stores when they hit the shelves. This continued for months. Everyone's necessities differ, so make a list of the items that you cannot live without and keep enough on hand in anticipation of future shortages.

Conclusion

A few years ago, there was a show on US television called Doomsday Preppers, which highlighted people stockpiling food, water, weapons,[7] ammunition, gas masks and whatever else they deemed necessary to survive life after doomsday. Initially, I thought the show was insane. In the end, however, my views have changed, and my behavior has changed. I now keep gas masks in the home, and I keep supplies of medicine. I also diversify my banks and assets. I have also learned to expect the unexpected. It may not always make the best practical or financial sense, but when something goes wrong, my family is protected.

7 https://en.wikipedia.org/wiki/Doomsday_Preppers

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