South Carolina Banking School
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Bank Investments

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Important Information:

All charts / graphs are shown for illustrative purposes only. Past performance does not guarantee any results or that any trend will continue.

Certain assumptions have been made in connection with analysis presented and changes in market conditions or assumptions may have had a material impact on results. There is no guarantee that any strategy will be successful.

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I. Banking 101

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Why is this class so Important?

Why are we here?

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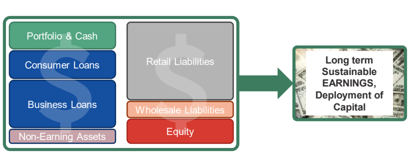
The Basics of Banking…

Your survival is dependent on long term sustainable earnings



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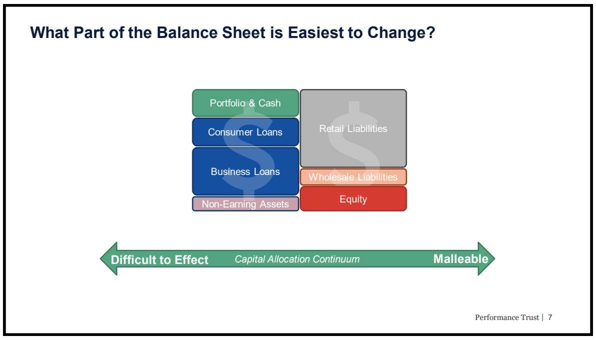
What Part of the Balance Sheet is Easiest to Change?
Portfolio & Cash
Consumer Loans
Business Loans
Non-Earning Assets
Retail Liabilities
Wholesale Liabilities
Equity
Difficult to Effect
Capital Allocation Continuum
Malleable
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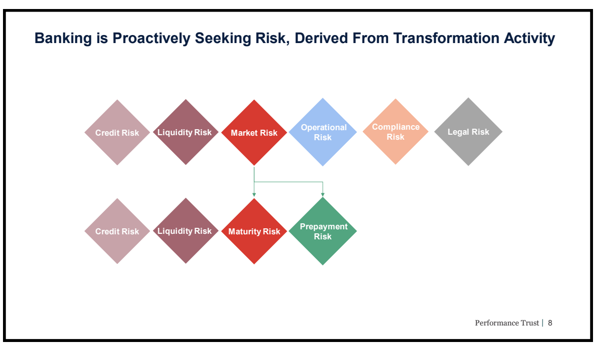
Banking is Proactively Seeking Risk, Derived From Transformation Activity
Credit Risk
Liquidity Risk
Market Risk
Operational Risk
Compliance Risk
Legal Risk
Credit Risk
Liquidity Risk
Maturity Risk
Prepayment Risk
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Banking is…
Banks Proactively Take Risk
Maturity Risk
Prepayment Risk
Credit Risk
Liquidity Risk
All of this is levered, ~ 10 to 1
And… RIGHTFULLY highly regulated!
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Banking is…

Banks proactively seek risk, derived from transformation activity

Goal: Maximize These Premiums that drive NII without taking too much Risk
Imperative to Monitor and Measure These Risks in an Uncertain Future

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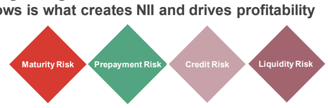
Banking is…

Seeking risk, derived from allocating capital to unlike cash flows

Nothing wrong with this. The existence of unlike cash flows is what creates NII and drives profitability



Imperative to know how it feels to be accountable to in different environments

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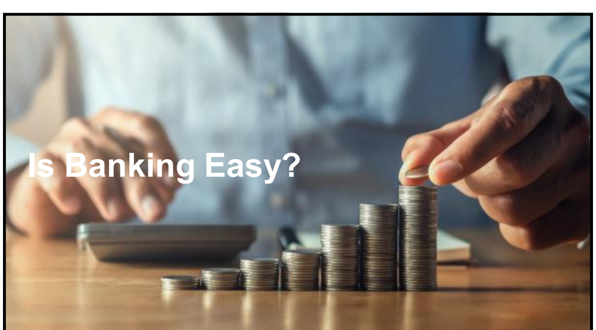

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1950's – 1970's | 3,6,3 Rule

3%	6%	3:00pm

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Reality Check: Banking Was Never That Easy!

Who are you trying to please?

Shareholders | Customers | Regulators | Employees | The Community.

Banking has never been easy!

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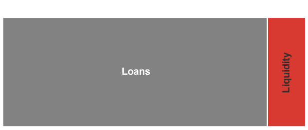
Traditional Balance Sheet View



Core Relationship (All In) > Target ROA/ROE

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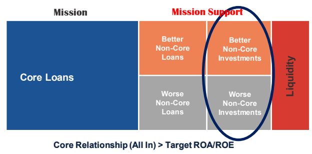

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Portfolio Purpose Statement

- The Investment Portfolio, like the Loan Portfolio, is a primary source of earnings for the institution.
- However, historically, the strategic importance of the bond portfolio has often been mistakenly undervalued.
- The goal should be to optimize earnings subject to liquidity and interest rate risk constraints.
- The portfolio should complement the rest of the balance sheet, so that no matter where rates go, our institution is strong.

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Investment Portfolio Purpose

1. Pledging
2. Liquidity
3. Earnings
4. Compliment or Hedge to the rest of the balance sheet

- The goal should be to optimize institutional earnings subject to liquidity and interest rate risk constraints.
- The portfolio should complement the rest of our Capital allocations, so that no matter where rates go, we have confidence our institution will be strong.

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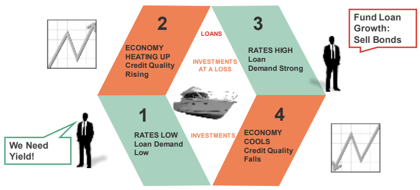
Portfolio Manager Trap



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Portfolio Manager Trap

- Financial Institutions tend to buy more bonds at the lows of rates and buy fewer bonds at the highs of rates.
- Financial Institutions tend to buy longer bonds at the lows of rates and shorter bonds at the highs of rates.
- Therefore, they tend to do the opposite of what fixed-income investors would prefer to do, which is to buy more long bonds at the highs of rates and fewer long bonds at the lows of rates.

Can this 'dilemma' be solved by guessing rates?

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Seeking Fixed-Income Outperformance is Not About Guessing Future Interest Rates

Every year, the Wall Street Journal surveys top economists as to their view on the future direction of interest rates.

How many even come close?

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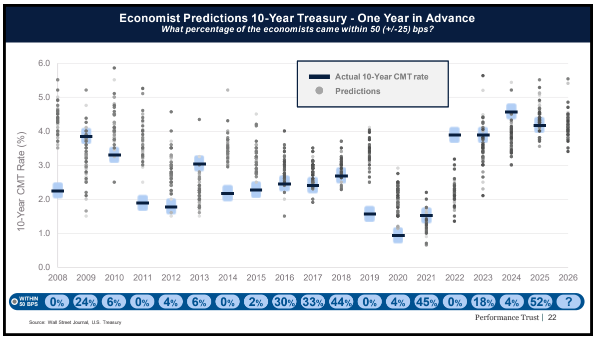
Economist Predictions 10-Year Treasury - One Year in Advance
What percentage of the economists came within 50 (+/-25) bps?
Actual 10-Year CMT rate
Predictions
10-Year CMT Rate (%)
6.0
5.0
4.0
3.0
2.0
1.0
0.0
2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022 2023 2024 2025 2026
WITHIN 50 BPS
0% 24% 6% 0% 4% 6% 0% 2% 30% 33% 44% 0% 4% 45% 0% 18% 4% 52% ?
Source: Wall Street Journal, U.S. Treasury
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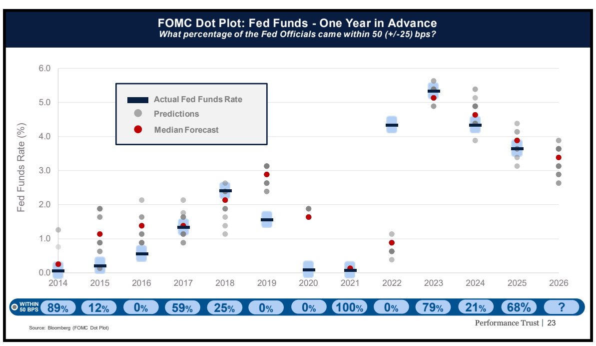
FOMC Dot Plot: Fed Funds - One Year in Advance
What percentage of the Fed Officials came within 50 (+/-25) bps?
Actual Fed Funds Rate
Predictions
Median Forecast
Fed Funds Rate (%)
6.0
5.0
4.0
3.0
2.0
1.0
0.0
2014 2015 2016 2017 2018 2019 2020 2021 2022 2023 2024 2025 2026
WITHIN 50 BPS
89% 12% 0% 59% 25% 0% 0% 100% 0% 79% 21% 68% ?
Source: Bloomberg (FOMC Dot Plot)
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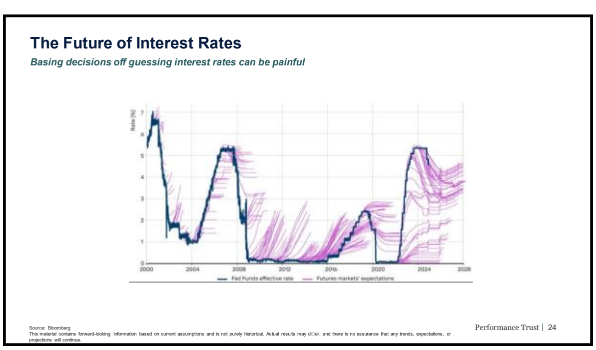
The Future of Interest Rates
Basing decisions off guessing interest rates can be painful
Rate (%)
2000 2004 2008 2012 2016 2020 2024 2028
Fed Funds effective rate
Futures markets' expectations
Source: Bloomberg
This material contains forward-looking information based on current assumptions and is not purely historical. Actual results may di er, and there is no assurance that any trends, expectations, or projections will continue.
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"We are prepared for a very broad range of interest rates, from 2% to 8%..."

— Jamie Dimon
2024 Letter to Shareholders

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Aren't Rates Going Down?

Maybe or Maybe Not

	CME FedWatch Tool - Conditional Meeting Probabilities As of 11/13/2024						CME FedWatch Tool - Conditional Meeting Probabilities As of 2/20/2025					
Meeting Date	325-350	350-375	375-400	400-425	425-450	450-475	325-350	350-375	375-400	400-425	425-450	450-475
3/19/2025	0.0%	0.0%	15.8%	46.1%	33.0%	5.1%	0.0%	0.0%	0.0%	2.5%	97.5%	0.0%
5/7/2025	0.0%	4.3%	24.0%	42.6%	25.4%	3.7%	0.0%	0.0%	0.4%	18.8%	80.8%	0.0%
6/18/2025	1.8%	12.6%	31.8%	35.3%	16.3%	2.2%	0.0%	0.2%	8.2%	45.0%	46.7%	0.0%
7/30/2025	4.0%	16.6%	32.6%	31.4%	13.4%	1.7%	0.0%	1.8%	15.8%	45.3%	37.0%	0.0%
9/17/2025	6.7%	20.0%	32.3%	27.6%	10.9%	1.3%	0.7%	6.7%	26.1%	42.4%	24.1%	0.0%
10/29/2025	8.4%	21.5%	31.7%	25.4%	9.7%	1.2%	1.8%	10.2%	29.0%	39.1%	19.8%	0.0%
12/10/2025	9.8%	22.6%	31.1%	23.8%	8.8%	1.1%	3.6%	14.4%	31.3%	34.8%	15.3%	0.0%

Target Range

Source: CME Group

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How Did We Prepare?

Region: United States » Instrument: Fed Funds Futures »
Target Rate 0.25 Pricing Date 12/31/2021
Effective Rate 0.07 Cur. Imp. O/N Rate 0.081

Meeting	#Hikes/Cuts	%Hike/Cut	Imp. Rate Δ	Implied Rate	A.R.M.
01/26/2022	+0.048	+4.8%	+0.012	0.093	0.250
03/16/2022	+0.632	+58.4%	+0.158	0.239	0.250
05/04/2022	+0.994	+36.2%	+0.248	0.329	0.250
06/15/2022	+1.495	+50.1%	+0.374	0.454	0.250
07/27/2022	+1.818	+32.3%	+0.454	0.535	0.250
09/21/2022	+2.286	+46.8%	+0.572	0.652	0.250
11/02/2022	+2.530	+24.4%	+0.633	0.713	0.250
12/14/2022	+2.958	+42.8%	+0.739	0.820	0.250
02/01/2023	+3.175	+21.8%	+0.794	0.874	0.250

Source: Bloomberg

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Unexpected

Long Term Impact

Source: Bloomberg
Past performance does not guarantee future results, and there is no assurance this trend will continue.

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Jamie Dimon Warns U.S. Might Face Interest-Rate Spike

2%

8%

Source: The Wall Street Journal, April, 8, 2024.

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Economist Predictions

"An economic forecaster is like a cross-eyed javelin thrower; they do not win many accuracy contests, but they keep the crowd's attention."

— Anonymous

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What Do You Care About?

Maximize Return Potential While…

Limiting Risk

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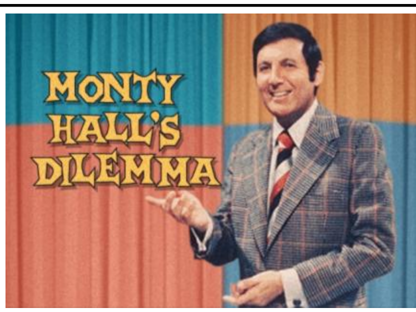

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Choose a Door…

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We Choose Door 2!
Now what happens?
LET'S MAKE A DEAL
1
2
Switch?
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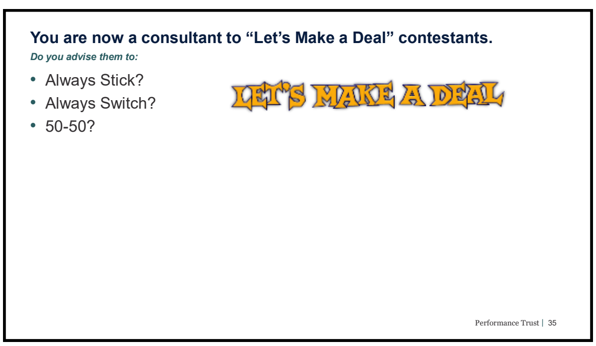
You are now a consultant to "Let's Make a Deal" contestants.
Do you advise them to:
• Always Stick?
• Always Switch?
• 50-50?
LET'S MAKE A DEAL
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LET'S MAKE A DEAL
1/3
1
2
3
2/3
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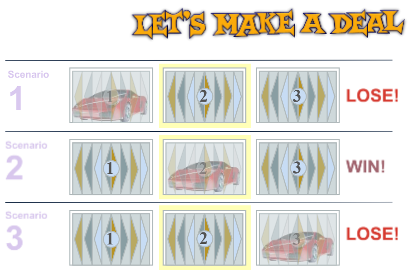
Stick



Sticking loses 2 out of 3 times

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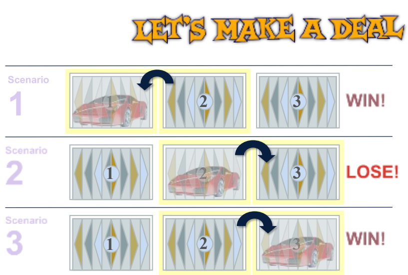
Switch



Switching wins 2 out of 3 times

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Lessons from Monty Hall's Dilemma

- Monty's information was disrespected and was in fact the key to success

Interpreting Important Information

- Intuition vs. Scenario Analysis

Intuition on Wall Street – The deck is stacked

- Non-rational behavior – Few Switched!

Wrong by inaction better than risking being wrong by taking action

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II. The Banking Environment Today

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Bank Balance Sheets Entering 2022

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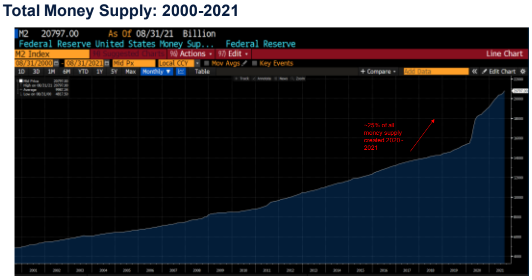
Total Money Supply: 2000-2021



Source: Bloomberg
Past performance does not guarantee future results, and there is no assurance this trend will continue.

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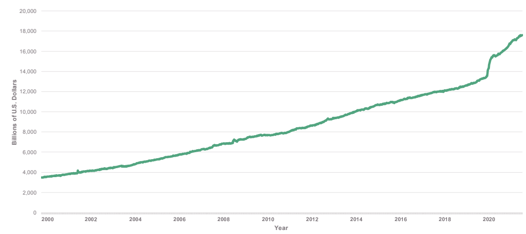
Consequently, FI balance Sheets Expanded Dramatically

Commercial Bank Deposits: 2000-2021



Source: Bloomberg
Past performance does not guarantee future results, and there is no assurance this trend will continue.

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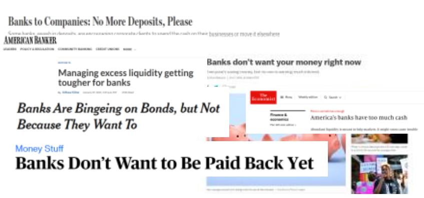
Too Much Cash …



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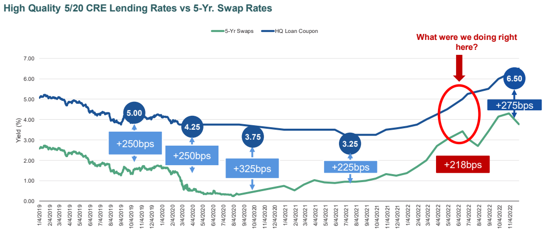
What About the Asset Side?

High Quality 5/20 CRE Lending Rates vs 5-Yr. Swap Rates



How should we think about allocating capital to lending?

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The Banking Industry…

State of the Market in 2021/2022:

Flush with Cash as margins were compressing

- Focused on what A/L modeling was telling them
- Attempted to forecast where rates were going

Which lead to…

- Adding long assets in the form of loans and investments and ignoring the impact of a rising rate environment – even as rates were rising

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March 10th, 2023

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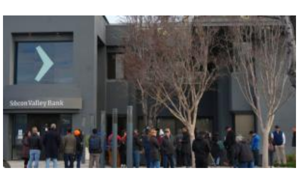
Silicon Valley Bank was Closed and the FDIC was Named Receiver



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Let's go back to Summer of 2022

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SVB Quarterly Investor Presentation

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Summer 2022: Financial Headlines

- Rates were up ~200bps
- Fear of Recession
- Rates stalling here
- Negative Deposit Betas!

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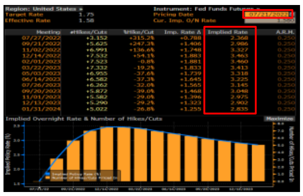
World Interest Rate Probability 7/21/2022

The future is not predictable



Source: Bloomberg
Past performance does not guarantee future results, and there is no assurance this trend will continue.

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Silicon Valley Bank

Source: Bank Director

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SVB Deposit Growth Increased Dramatically From 2020

Source: SVB Q2 2022 Financial Highlights Investor Relations Presentation, July 21, 2022.

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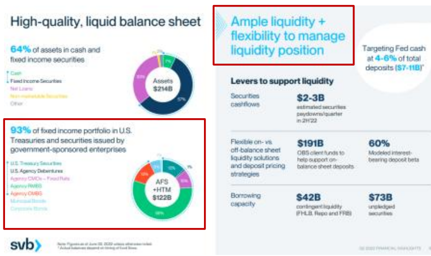
SVB Balance Sheet



Source: SVB Q2 2022 Financial Highlights Investor Relations Presentation, July 21, 2022.

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