Capital Ideas™

Investment insights from Capital Group

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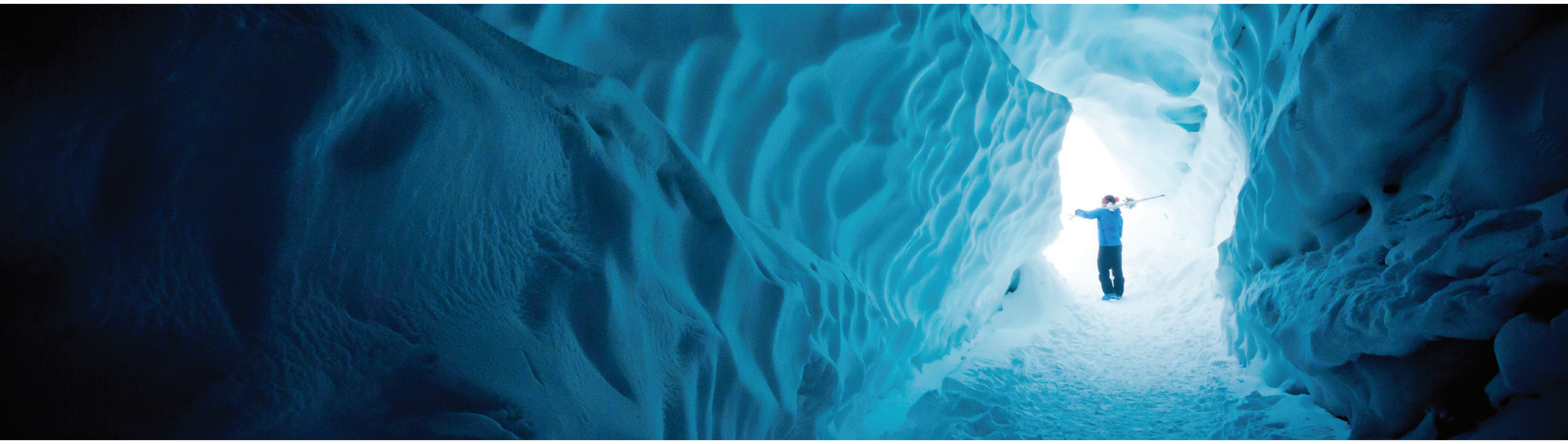


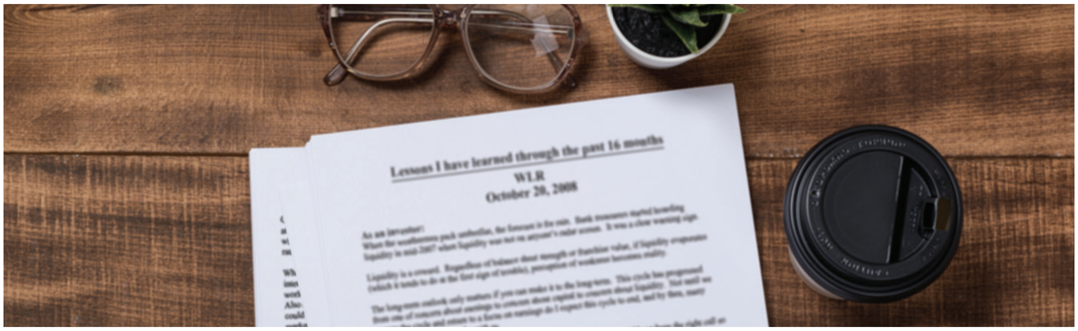
10 investing lessons from 2008 that apply today

Will Robbins
Portfolio Manager

We have been here before.

The failure of Silicon Valley Bank on March 10 reminds me of what I experienced firsthand as a bank analyst during the global financial crisis in 2007 and 2008.

As a professional investor for 30 years, I rely on my own experiences to help guide my investment approach. When I was a bank analyst then, I captured the 10 lessons below to serve as a guide for myself and colleagues to help get us to the other side of the valley.



Every crisis is different, but they often have things in common. Today's turmoil shares some striking similarities, though, in my view, this current episode is much smaller in scale and far less damaging.

Last summer, with rates rising, inflation high and the prospect of recession looming, I unearthed these lessons from 15 years ago and shared them again. And when Silicon Valley Bank failed a few weeks ago, I circulated them once more to offer perspective and help colleagues manage the uncertainty. Here are those lessons, which I believe bear repeating.

Investments are not FDIC-insured, nor are they deposits of or guaranteed by a bank or any other entity, so they may lose value.

Wisdom earned in crisis

1. When the weathermen pack umbrellas, the forecast is for rain.

Bank treasurers started hoarding liquidity – assets that can easily be converted to cash – in mid-2007 when liquidity was not on anyone's radar screen. It should have been a clear warning sign.

2. Liquidity is a coward.

Regardless of balance sheet strength or franchise value, if liquidity evaporates, which it has tended to do at the first sign of trouble, perception of weakness becomes reality.

3. The long-term outlook only matters if you can make it to the long term.

The 2007–2008 cycle progressed from one of concern about earnings to concern about capital to concern about liquidity. Not until we reverse the cycle and return to a focus on earnings do I expect this cycle to end, and by then many institutions may no longer be with us.

4. There is no silver bullet.

Selling into every rally on government fixes would have been the right call during the early stages of the global financial crisis. Drastic events require drastic measures; anything less would be a disappointment.

5. Avoid the most aggressive companies.

When you hear the words *growth* and *innovation* as they relate to lending businesses, proceed with caution. Making cross-industry comparisons can help provide guard rails for assessing where the dangers might be. Variations in outcomes between the least and most aggressive companies can be huge.

6. Bad news is bad news.

If a company needs capital and/or has to cut its dividend, consider getting out of the way, even if it looks like it's priced into the stock.

7. Don't try to navigate uncharted waters.

When circumstances change so drastically that even an experienced investment analyst has a hard time digesting events, I think it's best to walk away. This was true in the technology boom-bust cycle in the late-1990s as well as the global financial crisis. The break with the past was so significant in both cases that history no longer served as a guide.

8. Good loans are made in bad times and bad loans are made in good times.

The winners in a credit cycle will usually be those with the capital and liquidity to capitalize on the distress.

9. Trust your instincts and act.

The discontinuity of a crisis can be paralyzing, but it's important to remain flexible and continue to take action with a forward-thinking mindset.

10. Take care of yourself.

Sleep, exercise and healthy diet are important to maintaining a constructive attitude. We owe it to ourselves, our families and our clients to stay healthy.

Putting investing lessons into action

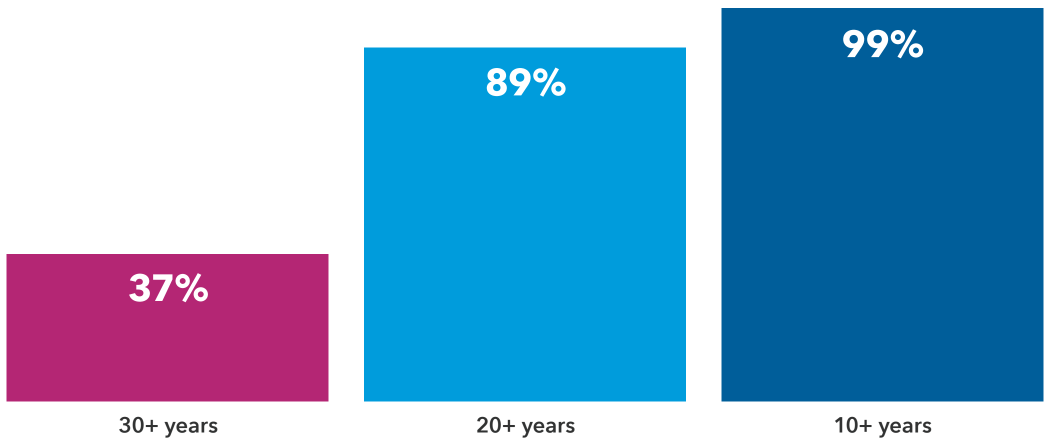
It is difficult to predict when the current crisis will end, but experience has taught me that it will and that we will get through this. Time and time again, markets have demonstrated a remarkable ability to endure and recover from crisis and thrive.

Today, as a portfolio manager and principal investment officer for American Mutual Fund®, I spend much of my time focused on preservation of capital and draw from my personal experiences in past crises in that effort.

I also rely on the wisdom of colleagues. At Capital Group we have many veteran investors with deep experience. Some 37% of our portfolio managers have more than 30 years of investment experience while 89% have 20 or more.

The importance of experience

Capital Group portfolio manager industry experience



Source: Capital Group (as of 12/31/22).

Moving beyond the banking turmoil

Moving beyond financial crises takes time and can be messy. Regulators have taken swift action to try to contain the damage and restore confidence, and they have been coming up with some very creative solutions. But those remedies will need time to be tested by the market. So, patience is crucial.

Going forward, I expect to see a dramatic tightening in lending standards. Small- to mid-sized banks are likely to be subject to stricter regulations – along the lines of the requirements for the largest financial institutions. Those likely include higher capital and liquidity requirements, periodic stress testing and restrictions on the types of investments banks can employ in their bond portfolios.

As in any cycle there will be winners. My view is that the strong will get stronger. That includes banks as well as companies in other industries that generate strong cash flow and can fund their own growth. For example, select technology giants are cash-flow positive today. Some of them made massive investments in their businesses when rates were near zero. It would be much more expensive for competitors to challenge those incumbents today.

Across industries, I believe opportunities will surface. The key for investors is to remain calm, look past the turbulence and be ready to act when opportunity does arise.

William L. Robbins *is an equity portfolio manager with 30 years experience (as of 12/31/2022). He holds an MBA and a bachelor's degree from Harvard.*

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