IFB355: How to Invest in Banks - A Step-by-Step Guide

All right, folks. Welcome to Investing for Beginners podcast. Today we have episode 355. Today we're going to teach you how to invest in a bank. So I know that sounds super exciting, but banks are a very big part of our economy and I think they're 13 or 14% of the S&P 500. So it's actually a pretty big chunk of the economy.

00:00:50 Dave

And.

00:00:52 Dave

Investing in them can be very profitable. I know it's probably not on your list of exciting things to do, but if you want to have good returns banks, you should consider a bank or two as part of your portfolio. So with that we can start talking about banks. One thing I just want to throw out there, banks have their own language, if you will. And Andrew and I are going to do.

00:01:13 Dave

Do our best to decode that for you today, but that's what really hangs up a lot of people when they think about investing in the banks. So it's the terminology goes, I have no idea what they're talking about. So today, our job is to try to demystify if we can. So let's talk about banks and what are your thoughts on investing in banks and how should we start?

00:01:34 Dave

Trying to analyze.

00:01:35 Andrew

Them I would try to categorize them as you have the.

00:01:41 Andrew

Quote UN quote too big to fail, which was a very popular phrase 1012 years ago.

00:01:48 Andrew

No.

00:01:50 Andrew

And those tend to be more integrated I guess. And then you have more of your traditional kind of bread and butter type of bank and those tend to be regional. And so depending on what kind of bank you're looking at.

00:02:07 Andrew

Something like a JP Morgan Chase, which I own shares in or Bank of America, which I used to own shares in. Don't ask me about. That's a sore topic.

00:02:16 Andrew

Those are very complex. They have a lot of different.

00:02:21 Andrew

Branches and business types kind of all rolled into that versus something like like a bank down the street called Fifth Third Bank. That one's very simple and kind of break them by their banking.

00:02:34 Andrew

So.

00:02:35 Andrew

If you're intimidated, when you look at JP Morgan Chase or Bank of America and you say, oh, Oh my goodness was a million.

00:02:42 Andrew

Pieces in here.

00:02:43 Andrew

Well, that's OK. That doesn't mean you're not going to understand what the bank is. It just means that some of the too big to fail ones are really, really complex and.

00:02:52 Andrew

You know, you just have to manage that, but to me it kind of starting with the bread and butter regionals helps to build that foundation and then you can kind of leap off of that into the more complex stuff. If that fits your fancy.

00:03:07 Dave

Yeah, exactly. I did the exact reverse. I started with JP Morgan, the hardest one, and tried to feel, you know, backward engineer that. And let me tell you their 244 page 10K was enough to almost kill me. But.

00:03:23 Dave

Yeah, once you know.

00:03:24 Dave

After that, everything else is a lot easier, but I agree.

00:03:27 Dave

I think starting with more bread and.

00:03:30 Dave

Or generic plain Jane however you want to phrase it. Banks, I think, is a much easier way to go and you can kind of work your way up to the JP Morgan's of the world because they can be great investments. But like you said, there's lots of pieces and lots of moving parts, and it's if you don't.

00:03:45 Dave

Really understand that.

00:03:46 Dave

You could miss something for sure, so let's start with.

00:03:50 Dave

How do banks make money? That's kind of important. So what are your thoughts?

00:03:54 Andrew

On that, I like to think of it. They'll buy them other way and then obviously something like Bank of America could have lots of ways to make money. But in the brother, in the brand and brother.

00:04:04 Andrew

Model in the normal interest rate environment, which we haven't had for a while, a bank takes deposits and then it goes out and uses that those deposits to make loans. So if Dave wants to go bank at Bank of Andrew, you give me your $1000 and then I go make a loan to the neighbor down the street so he can buy a car.

00:04:24 Andrew

Or house or whatever it is.

00:04:27 Andrew

And so there's a spread the money that the bank pays to the person who deposited the money, and then the money that goes out to a mortgage or a car, the interest rate on the mortgage or the car will tend to be higher than the money that somebody made on their deposits. And so that spread is where the bank makes its money.

00:04:47 Andrew

That's how I like to think.

00:04:48 Dave

About it. Yeah. So that's like the perfect way to think about it. When you're looking at a bank, you have to understand that it's kind of reverse bizarro land. Like debt is a different thing in a bank than a normal company, and deposits are actually liabilities because it's money.

00:05:08 Dave

That the bank owes to us. So when and when I go in your example, when I go to the Bank of Andrew and I give you $1000 now Bank of Andrew has $1000 liability on their.

00:05:20 Dave

One cheat because they owe me that $1000. That's my money, even though they can go and loan it to, you know, Andy down the street for $500, they still owe me $1000. And so that's why it is liability. But the kind of the bizarro part of it is that that's actually the raw material that they can use. I'm stealing the line from.

00:05:40 Dave

Those with the motor and it's the raw materials that they can use to go out and grow.

00:05:45 Dave

Revenue and income for the bank is by using that money and that's the way the system has worked for hundreds of years, and it doesn't matter whether it's a car loan, a mortgage credit card, it all kind of operates under the same guys. And so the loans that the bank lends out, so if.

00:06:06 Dave

I go to the Bank of Andrew and ask him for a car loan, then that's actually an asset on their balance sheet because that's how they're going to make money is from.

00:06:16 Dave

From that loan that they give me and it's not just the $15,000 that I buy for the car, it's actually the interest that they earn from me on the loan. And so when you go and buy a car, if you have recently or if you haven't in a while, I know when I was working in the bank, that's one thing that stood out to me was the little document.

00:06:17

Well.

00:06:38 Dave

That we would give to customers showing them, hey, you borrowed $15,000. Here's how much you're going to pay us in interest, $5000 over the next.

00:06:48 Dave

Five years now, you you actually owe me $20,000, not 15. And that's how the bank makes money is on that $5000. And so that's.

00:06:57 Andrew

Kind of how?

00:06:59 Dave

A bank works and I think the easiest way to think about when you think about different businesses. One of the things that I think makes banks a little different than let's say, compare it to.

00:07:08 Dave

Apple or Microsoft with Apple or Microsoft when you analyze the companies, the balance sheet to me feels a little more reduced in like the in.

00:07:18 Dave

Importance of analyzing the business. I'm not saying it's important, but the balance sheet in banks and insurance companies is very important. That's really where you can see where the rubber.

00:07:28 Dave

Meets the road.

00:07:29 Dave

With those kinds of businesses, I feel like it's a little less important with a visa, for example, than the cash flow statement or the income statement. So it's a little bit.

00:07:38 Dave

Backwards to when you're normally analyzing a company. So now that we kind of understand maybe how the banks make money, let's talk about the income statement and maybe how it different, how it's different than leading Microsoft's income statement. So I guess what are your thoughts on that? How can we start breaking that down?

00:07:57 Andrew

What's the best way to steward your wealth looking to find great businesses with a margin of safety? My advice? Value spotlight@valuespotlight.com.

00:08:09 Andrew

Yeah. So to further that along and maybe assign some line items to some of the things we've talked about. So any money that a bank might make on the loans, they call that like net interest on loans or something interesting interest income. Thank you, yes. And then.

00:08:29 Andrew

A bank can also maybe.

00:08:30 Andrew

The.

00:08:31 Andrew

By their own investments, so that would be interest on investments or interest on securities. And so instead of having one revenue line like pretty much every other company, you have multiple revenue lines that go into a total revenue line and then you're netting out deposit part.

00:08:51 Andrew

And so it's kind of that's where it gets confusing, because there's no top line per say. There's like groups of.

00:08:59 Andrew

Top lines and.

00:09:02 Andrew

Maybe a few bottom lines and then and then you could have all.

00:09:04 Andrew

The complexity of.

00:09:05 Andrew

A non interest income as well. So if you know a bank charges.

00:09:11 Andrew

Or a credit card account, or, you know, maybe they charge payment processing fees. Those can also show up on the different side of the revenues.

00:09:22 Andrew

But or both and bother, you do have usually multiple top lines and then.

00:09:29 Andrew

They have something that's interest expense. How much are they paying to the depositors? And then you get a net interest income, which is top minus bottom, yeah.

00:09:40 Dave

Exactly. Yeah, exactly. And the way I try to look at it is when I'm thinking about the interest income that the bank makes from their multiple lines of businesses.

00:09:52 Dave

I try to think of it like segment.

00:09:55 Dave

Like segment revenue, when you think about Apple, you know Apple makes money from their iPhones, they make money from their iPads, they make money from their services and those are all separate line items. And some companies like Apple will break those out. Other ones will to lump them all together. So it's a little more opaque. And with banks, it's kind of the same thing. So they'll make.

00:10:15 Dave

Meal as Andrew was explaining, they'll make money from.

00:10:18 Dave

Interest that they on loans and credit cards, but they also have their own investments. They'll buy their own investments, whether it's treasuries or stocks or something. And the money that they make from that was is also income. But then they also have non interest related businesses like he was talking about like they have a payments processor or maybe they have wealth.

00:10:38 Dave

Advisors that are helping people grow their own money, and so the fees that you pay for that is not related to interest.

00:10:46 Dave

That the bank can earn, and so the banks usually have like 2 separate like interest income section with assorted things, and then has a non interest income section with all the assorted things. And then you have all the expenses like you're paying rent, paying for people all the same things you have for other businesses and then.

00:11:06 Dave

They kind of balance that out. So it's when you look at an income statement, it can be a bit confusing, but if you understand where the revenue is coming from and how they're separating it and then comparing those to the cost of generating those revenues, then it it becomes an income statement. And once you kind of.

00:11:23 Dave

Understand that it to me anyway it it reduces some of the complexity and maybe some of the scariness of looking at an income statement and to Andrew's point looking at a bank like Fifth Third Bank, which is not, I wouldn't say generic is not the right word for it. But I guess more standard if you will type of bank is a really good place to start.

00:11:44 Dave

Because they break it down very clearly and there's not a lot of extraneous other things that get mixed in there. And so it could be a good place to, you know, use as your starter bank. I'm not suggesting you go out and invest in fifth. You know, Fifth Third Bank, unless you find things that are attractive. But as from a purely.

00:12:02 Dave

The I guess analytical or academic exercise, I think it's a really good place to start because it's a very kind of generic bank. So I guess beyond the income statement, like when you look at the balance sheet, what are some things that you look for beyond maybe deposits and loans? Are there anything that you would look beyond? Those are those like too critical?

00:12:24 Dave

Items you want to know more about.

00:12:27 Andrew

That's why in the order of criticality, I would probably put the loan book up there, number one, and then the deposits is number.

00:12:36 Andrew

The way that they manage their investments is probably close there because that kind of tells you basically capital allocation of management and that might not sound like a huge deal until you get what happened with.

00:12:50 Andrew

First Republic in Silicon Valley Bank, they showed.

00:12:53 Andrew

Some of the risks of what happens when management doesn't do good capital allocation.

00:12:58 Andrew

Because you know a good bank, I like the way.

00:13:00 Andrew

Jamie Dimon.

00:13:01 Andrew

Explains it, he says. We'll run.

00:13:04 Andrew

To find success, no matter what the interest rate environment is, no matter what forward forward interest rates due, we're going to be here, we're going to serve the economy and you know banks, some banks take bets, some interest rates and sometimes it pays off and sometimes it blows up in their face. So you you will find that.

00:13:24 Andrew

On the balance sheet, but a good way to to analyze the risk of a bank. As you astute astutely reminded me earlier, our conversation earlier today is with the loan book. So can you kind of explain what the loan book is and?

00:13:38 Andrew

Like what that comprises and what people should look.

00:13:41 Andrew

At in there.

00:13:42 Dave

Yeah, that's a whole other area. I mean, we could probably do a podcast just on.

00:13:46 Dave

Loans alone.

00:13:47 Dave

The basic I guess overview if you're looking at the bread and butter of a bank, there's kind of two components like we talked about deposits, loans is the other bread and butter and that's where the rubber meets the road for almost every bank. And that's really where they're going to make the majority of their money.

00:14:05 Dave

Through loans. And so the first thing you probably need to really determine when you're looking at a loan book of a bank is what kinds of loans are they getting out. So in other.

00:14:16 Dave

Was do they? I'll give you a few examples. So Ally Bank is known for being one of the leaders in auto loans. So if you want a car loan, chances are you either go to Ally Bank or you'll get it through your car dealership via Ally Bank because of the relationships they have with car dealers. And so that's what they're known for.

00:14:36 Dave

Wells Fargo is known for mortgages. That's really kind of their bread and butter. So when you buy a house, you either go through Wells Fargo or your mortgage broker may.

00:14:47 Dave

Do their loans through Wells Fargo. And so that's what they're known for. So when you're looking at a bank, one of the things you want to determine is what is there? What is their thing? What are they known for? Sometimes it can be, you know, 33 percent, 33 percent, 33% of, you know, three different things. Sometimes it could be a whole lot of.

00:15:07 Dave

One, sometimes it can be 14 things. It really depends on the bank where they're located and what kind of customers they cater to. There will be some banks out in the world that cater to more.

00:15:20 Dave

Commercial customers, so they don't deal with the Bank of Andrew may be completely retail. In other words, it's just local people in the area all go to bank there and then they give out car loans and mortgages and credit cards and and standard fare. You may have other banks right next to it. You know the Bank of Andy may be a commercial bank and they only.

00:15:40 Dave

Deal with businesses. They only give out commercial loans to buy mortgages of other buildings, or maybe to invest to grow their businesses. Things of that nature. So the first thing you need to determine when you're looking at a bank is what kinds of loans do.

00:15:54 Dave

They give out who are their cut.

00:15:56 Dave

Summers. And so that's kind of the first thing. And then the next thing you need to try to figure out is what kinds of like what kind of money do they make on those loans? Like, what is their net interest margin? And so that's really what Andrew was talking about before. You want to see what what kind of profit do they make from the loans that they give out? So.

00:16:16 Dave

What is the interest rates? They offer loans to versus what kinds of interest rates do they offer on deposit?

00:16:23 Dave

That's and so you want the bigger the gap. Obviously, the more money it makes, we're not going to have a morality conversation today about.

00:16:31 Dave

You know all that kind of stuff, because that could be a real rabbit hole. But just as a general rule, the bigger the gap, the more money that the bank is going to make, but they always have to balance that out. So that's the next thing. And then I guess one of the third things that we want to look at is try to have some sense of what kind of credit quality they're of the customers that they're loaning the banks.

00:16:52 Dave

To do so, again, to go back to my earlier references, Ally.

00:16:56 Dave

Bank generally has a lower credit rated customer than a bank like JP Morgan would or a bank like.

00:17:04 Dave

5th 3rd would.

00:17:06 Dave

And because car loans generally attract lower credit scores because they have that physical asset that the bank ally can loan against. And so if you go in there and you have let's say.

00:17:19 Dave

A 640 credit score, which is not horrible, but it's not great.

00:17:23 Dave

You're more likely to get a car than if you go to try to get a business loan with a 640 credit score. They may not give it to you because you don't have a high enough credit and so ally generally tends to attract lower credit scores overall for their loan book. And so that's a risk of investing in ally because of that.

00:17:42 Dave

Lower rate and the flip side of that is Fifth Third Bank which does a a wide range of mortgages and commercial loans. They tend to have a much higher credit score for their customers. Usually I think the last time I looked, I think it was seven, 10715 something like that. So pretty good.

00:18:01 Dave

And so they attract those kinds of customers to loan out money, which makes their loans in theory safer because you have a higher credit score. And that tends to give you, I guess, a little more stability in how well the bank is going to do over time. And so I guess those are three of the things that I look for. What else would you add to my soapbox?

00:18:23 Andrew

The beautiful soapbox soup of bank metrics. I'm having fun swimming in it on the balance sheet itself. You may or may not get as much information really, where the gold mine is is in the notes of the financials and so.

00:18:41 Andrew

To find like the credit score and things like that that they have us talking about, you can find that in there. One other thing I like to look at is.

00:18:50 Andrew

Again, because all of these are regionals and based in the United States, there's so many banks, by the way, that you could buy stock in in the United States right now it's it's kind of crazy. You can look at like geographic concentration or in the case of commercial, you can look at industry concentration. And so that can sometimes give you a sense of.

00:19:10 Andrew

Oh wow, these guys do a lot of business in California or oh, wow, they really serve the real estate market or they really serve grocery stores or whatever. Reason, those things can help you put the pieces together as far as the profile or the portfolio of loans that they have and how risky.

00:19:30 Andrew

You're safe. You think those are now as it comes through? You know the downside, obviously, to making a loan is somebody could default, right?

00:19:41 Andrew

And that's a risk the bank has to take and why they do need the spread because certain number of their loans are going to default. So when that happens, how does that play out in the financials and is there an easy way to think about that for somebody who's new to analyzing the bank?

00:19:58 Speaker 5

What's the biggest problem most investors face? Valuing a.

00:20:02 Speaker 5

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00:20:23 Speaker 5

Thatsdcf123.com.

00:20:29 Dave

Yeah, that's a. That's a great, great point. There is usually a line item on the income statement that will talk about.

00:20:39 Dave

The charge offs or the bad loans? It's a bad loan expense and.

00:20:45 Dave

What banks will do is they will set aside.

00:20:48 Dave

Me.

00:20:49 Dave

To cover those bad loans. So basically what they do is let's say the Bank of Andrew makes $2000 in profit. They will take $200.00 of that out of their profit and basically set it aside, set it aside for a rainy day. So it sits on their accounts as a potential covering.

00:21:10 Dave

Of me making a bad loan or me having a bad loan defaulting on my $200 car loan and that will make sure that the bank doesn't lose money if they make a mistake in their.

00:21:24 Dave

Allocating of loans to people and doing their credit risks on potential to potential debtors, and so each bank and those and that money accumulates. So every year that they set aside money that just accumulates in an account. And it just piles up. And so during.

00:21:44 Dave

The perfect example is.

00:21:46 Dave

During the pandemic, a lot of banks, when it first started, a lot of banks 5th, 3rd ally JP Morgan. They all upped their, you know, bad expense money a lot and they set aside a lot of money, millions and trillions, not trillions but billions of dollars they set aside.

00:22:01

Hmm.

00:22:06 Dave

Because everybody anticipated that people were going to default on mortgages, car loans and.

00:22:11 Dave

Etcetera. And when that didn't come to pass, that money could be allocated back into the income statement as money that they can use to buy back shares or pay off debt or whatever. And so it's not money that goes away forever and it can ebb and flow depending on what's going on in the economy. So whenever there is.

00:22:31 Dave

Left times that come about, you may see banks start to set aside money or these are it's called provisions.

00:22:38 Dave

For for bad.

00:22:39 Dave

Loans and they will do this periodically to set aside when they think times may be rough or tough, and this is all a reaction to what happened during the great financial crisis in 2007 and 8 was banks were not prepared for defaults on loans, mortgages and and such.

00:22:59 Dave

And so this was in reaction to that as a law that was passed that requires banks to set aside a certain portion of their money to set aside to make sure that they have enough capital in case there is something that goes wrong the way most banks do it is you can compare it to their overall revenue and kind of see a percentage and.

00:23:20 Dave

I'm not aware of like any particular the number like 2% is perfect. It's going to depend bank on by bank allied bank because they have lower credit scores, probably will run with a higher percentage of provisions than a company like 5th 3rd would because of the nature of their loan book and who their loan lending money to. But it's a great way.

00:23:40 Dave

To check and see how well capitalized the bank is.

00:23:46 Andrew

Would you say Allied stock tends to be a lot more volatile than to think like 5th thirds?

00:23:54 Andrew

For sure, you think the credit thing plays a role in that.

00:23:57 Speaker 1

Yeah.

00:23:58 Dave

Yeah, absolutely. That and the the tying to the the auto industry. So if the auto industry is seeing a boom in car selling then Ally Bank is probably seeing a big boom in more loans going out. Likewise when the the car industry sees a decline.

00:24:15 Dave

Been interested in the.

00:24:16 Dave

Goals or interest rates are too high and then they will see a decline in their loan book and that directly impacts the stock price because investors expect the company to make money from loans and when they aren't making loans then they're going to punish the.

00:24:31 Dave

Bank for that, yeah, yeah.

00:24:33 Andrew

It's fun, right? Like there's so many ways to play.

00:24:36 Andrew

Like, if you're bullish on electric vehicles, you don't have to buy an EV car maker to.

00:24:42 Dave

Just buy Ally Bank.

00:24:44 Andrew

Yeah, totally. Yeah.

00:24:46

Yeah.

00:24:48 Andrew

So anything else kind of around the balance sheet that you feel like requires more thought, I mean all of it could require more thought, but like big picture kind of trying to learn this business as a beginner or anything else stand out that's a good question.

00:24:57

Right.

00:25:06 Dave

Really, the only other thing that I could.

00:25:08 Dave

Think of would be to look at.

00:25:12 Dave

What kind of equity is the bank building?

00:25:14 Dave

Up.

00:25:15 Dave

Because the the book value or the equity of the bank is really one of the ways that you can value the bank. Because at the end of the day, if the bank goes out.

00:25:25 Dave

Of business.

00:25:26 Dave

Really what we can get as investors is the equity of the bank.

00:25:31 Dave

And technically, you could probably buy the loans and that's kind of what happened with Silicon Valley Bank and and First Republic is you can buy those assets, but the really the way that you can tell whether a bank is growing its value is by looking at the equity or the shareholders equity which is at the bottom of the balance sheet.

00:25:51 Dave

And if you see that growing 1012% a year, that's awesome because that's our value. That's what you and I get for owning allied bank or Wells Fargo. And so if that's growing at 1012%, that's that means the earnings are growing at 1012% and that's.

00:26:11 Dave

You want that? That's a great thing. That's not much different than looking at Microsoft, but I don't think that gets as much. Probably love as it would in a bank, for example.

00:26:23 Andrew

Yeah, it's. It definitely doesn't come intuitive if you're first starting out. I mean, the earnings EPS can swing like crazy in the short term for a bank. But like you said, raw materials, the balance sheet is the raw materials. And so that tends to grow up kind of slow and steady. If you have a good bank like you said, some of the provision for.

00:26:44 Andrew

Losses and things like that make the earnings quite volatile sometimes.

00:26:48 Dave

Yeah, exactly. Bank. I feel like the balance sheet is really the the best place to get a sense for the quality of the bank and also how well the bank is run.

00:27:00 Dave

You can glean a lot of insights into management from how how well they manage the balance between growing deposits and giving out loans and cash on the balance sheet and equity.

00:27:13 Dave

And through those.

00:27:14 Dave

4 sections you can tell a lot about how conservative the bank is, or how aggressive.

00:27:20 Dave

The bank is and those can go a long ways towards telling you whether these kinds of managers are people you want.

00:27:28 Dave

To invest with and run the bank that you want to buy.

00:27:33 Andrew

Yeah, really good, really good insight there.

00:27:36 Dave

Do you want to throw a few metrics out there for people to look at?

00:27:39 Andrew

Yeah, I'd love to. And I'd be curious if anyone's still listening after that.

00:27:46 Andrew

A loan to deposit ratio is a good one.

00:27:49 Andrew

You know, maybe buying investments for all different types of reasons, but that's one of those levers that can tell you how aggressive a bank is being with how much money they're lending out versus how much are they kind of keeping and either saving for a rainy day or they.

00:28:05 Andrew

For whatever reason, don't feel like they they need to make.

00:28:07 Andrew

As many loans.

00:28:08 Andrew

So in general, the banks with the higher loan and deposit ratios are going to have higher growth rates because more of their money that's coming in is.

00:28:17 Andrew

Getting put to.

00:28:17 Andrew

Work. And so that's a ratio between.

00:28:21 Andrew

They could go zero to 100% to above 100%, but that's one that sticks out to me and something I wish I took more seriously when I was first looking at bank.

00:28:32

It's.

00:28:33 Dave

It's a great ratio. I think one of my favorite ones is the one I call SETI that stands for common equity Tier 1 and it's a regulatory ratio. Don't worry about trying to calculate it because there's lots of stuff that goes into it and you don't need to worry about that. It's not necessarily about how they.

00:28:52 Dave

Calculate it and the numbers behind it. You just need to maybe understand where your bank is on that ratio and so this is this is something that was set up again during the great financial crisis.

00:29:04 Dave

To they had it in place prior, but they've raised the the minimums, if you will. And so now this is really a great ratio to at least understand and know for your bank to tell how well capitalized the bank is in the event of some sort of catastrophe. So they do these things called stress tests for banks.

00:29:24 Dave

Where they basically go to the bank and look at their financials and what kind of money they have.

00:29:29 Dave

In the banks and what they owe, and they run different scenarios based on like, you know, things like global upheaval, you know, zombie, a cop, apocalypses and stuff like that, not actually zombies. But, you know, if there's some sort of a pandemic or if there's, you know, a global volcano eruptions around the world.

00:29:49 Dave

And it disrupts the economy. Yeah, just all these kinds of things. And they want to see how the bank would be able to handle basically giving us our money back if something like that.

00:29:58 Dave

Happen. And so they run these tests and they base them on this steady ratio and generally like anything else, the higher the better. And so if you look at Wells Fargo, they're probably running at steady ratios 10 1/2 to 11 1/2 JP Morgans. There are 13 to 14th. And so the higher.

00:30:19 Dave

That is, that means the more capital they have to cover their butts in case something bad happens, Charles Schwab, it was not is a bank, but kind of not a bank, but their ratios actually are kind of low right now. So those are things that it's very easy. They have to report them in the 10K.

00:30:34 Dave

And so I would do control F and type in CET one and then it'll pull up where it is in the notes section and you can just very quickly find out what your what the ratios are for your particular bank. And it's a very great way to see how safe a bank is for you when you're looking at a margin of safety, investing in a bank. That's the way.

00:30:52 Dave

I look at it anyway.

00:30:54 Andrew

Yeah, that's that's an awesome one. Definitely, definitely tells you a lot about how conservatively, how solvent are they and how resilient.

00:31:04 Dave

Yeah.

00:31:05 Andrew

Yeah, I want to be the guy who yells B word on an airplane. There is something about banks that make them different than other stocks and is the risk of a bank run and that has played out their history and we saw it recently and.

00:31:23 Andrew

It's something to keep in mind.

00:31:25 Andrew

Also, when you buy a bank, you know the.

00:31:29 Andrew

We don't have to get into the nitty gritty of like FDIC and everything, but people's checking accounts are covered through the FDIC up to certain limits and then you can have multiple bank accounts to kind of cover yourself.

00:31:42 Andrew

But.

00:31:45 Andrew

For one reason or another, if there's panic or risk in the business, people can.

00:31:50 Andrew

Behave like the herd can, so that's a risk to be cognizant of when you invest in the bank stock.

00:31:58 Andrew

One of the metrics I saw bandied about during some of this upheaval was banks giving disclosures on what kind of depositors they had, and like the diversity of those depositors, and some banks serve certain demographics more than others. Something like a Bank of America kind of serves.

00:32:18 Andrew

Like almost anybody, right versus Silicon Valley Bank maybe has a very certain type of depositor that comes from a certain area and that led to some problems for them, so.

00:32:30 Andrew

You know something to keep in mind are like.

00:32:33 Andrew

JP Morgan and Bank of America sometimes talk about transactional deposits like it's transactional cash. I can kind of tell you something about the type of depositors they have. Yeah, you can't ever reduce risk completely with any investment, but that is something to be cognizant of. And so you do want to look for banks that are run.

00:32:52 Andrew

By ethical people.

00:32:54 Andrew

That have solid reputations, reputations of integrity, reputations of taking care of their customers and so that way, you know, people understand that these are high quality banks and that you know the money is being put to good work.

00:33:10 Dave

Yeah, well said. Well said. All right, folks, with that, we will go ahead and wrap up our conversation for today. I hope we helped demystify banks a little bit for you. And if you have any questions, please reach out and let us know. We're happy to try to help. I have written some blog posts about banks. It's an area of interest for me and Andrew as well.

00:33:30 Dave

And so with that, we'll go ahead and sign us off. You guys go out there and invest with the margin of safety emphasis on the.

00:33:35 Dave

Safety. Have a great.

00:33:36 Dave

Week and we'll talk to you next week.

00:33:39 Speaker 2

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Have a prosperous day.

00:34:04 Speaker 6

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