THE BIG SECRET ON WALL STREET

Run For Your Money

- The Hidden Risks Of This Very Big Bank
- What Every Investor Should Know... And Do

FROM THE DESK OF PORTER STANSBERRY

SPECIAL REPORT

In 2020, the CEO of one of America's largest banks made what may well be the single worst investment in the history of capitalism when he bought half a trillion dollars worth of long-duration mortgages paying only about 1% a year. As a result of this huge investment in low-yield, high-duration bonds, the bank can only afford to offer its customers 0.01% to 0.04% on their deposits... while its competitors are able to offer around 4%. This makes it very vulnerable to a run on the bank if its customers pull their money out to put into another bank offering higher interest rates on their deposits.

In fact, there isn't any logical explanation for why such a run hasn't already occurred... and when it happens this bank is unlikely to be able to cover all the customers' deposits.

The only thing that can really protect this bank is a long-term reduction in interest rates. And with the Fed signaling that rate cuts are over for now and with an incoming Trump administration instituting policies that are likely to increase inflation and therefore lead to higher rates... this bank's one lifeline might be slipping away.

As a result, we are doing something that we rarely do. We are recommending that investors take a short position in this company, which means that we're betting the share price will *decline*.

We hope you enjoy the research provided in this report... It demonstrates the type of work we provide every week in *The Big Secret on Wall Street*.

Run For Your Money

The Hidden Risks Of This Very Big Bank

What Every Investor Should Know... And Do

Bank of America (BAC) has long been a pillar of the nation's financial industry. It's the second-largest bank in the United States, with $3.3 trillion in assets. Around one in five Americans has an account there, entrusting it with $1.9 trillion in deposits, which is 11% of total U.S. bank deposits. It's a linchpin of not just the American but the global financial system.

So... you'd hope that it is one of the safest, most closely regulated, and stable financial institutions on Earth.

The thing is… it's not. In fact, I'm convinced that Bank of America is going to go spectacularly bust. And when it does, it's going to take down a lot of other banks – and make the bank runs of Silicon Valley Bank, First Republic Bank, and Signature Bank and in the spring of 2023 look like a walk in the park by comparison.

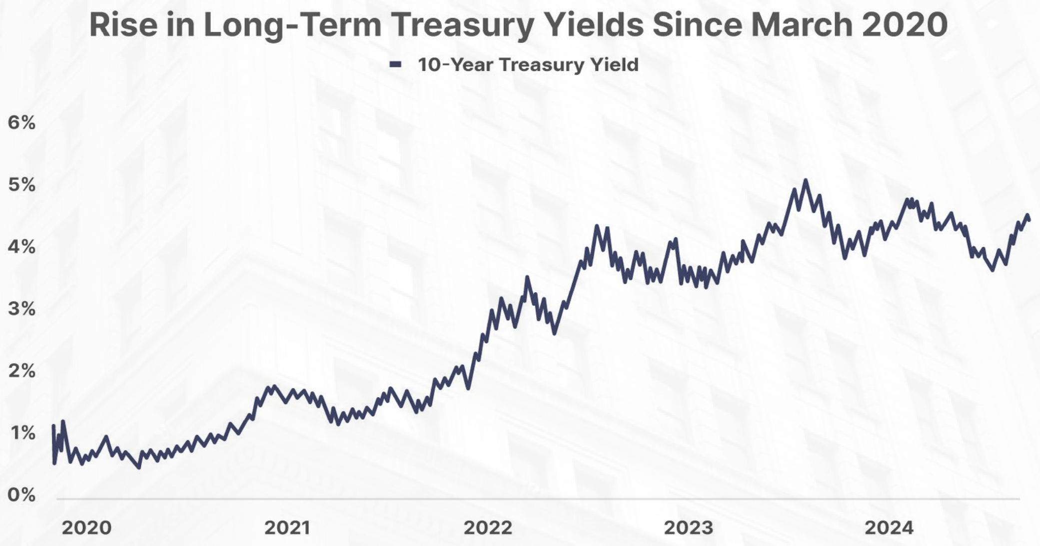
The Problem With Bonds

First, though… a bit of background.

Beginning in 2020, the massive COVID bailouts resulted in $7 trillion in new money being created, which ended up as deposits in the biggest commercial banks. Banks had to invest these funds somewhere, and banking regulation heavily favors buying U.S. Treasury bonds and "Agency" debt, which are both backed by the U.S. Treasury.

The result has been a surge in holdings of these securities by U.S. commercial banks. Since early 2020, U.S. commercial banks increased their holdings by nearly $1.5 trillion, rising as a share of total assets from 19.6% to 23.0% as of the end of Q2 2024. Beyond the significant growth, the increased holdings were in longer-dated maturities, extending portfolio duration, thus exposing banks to heightened interest rate risk.

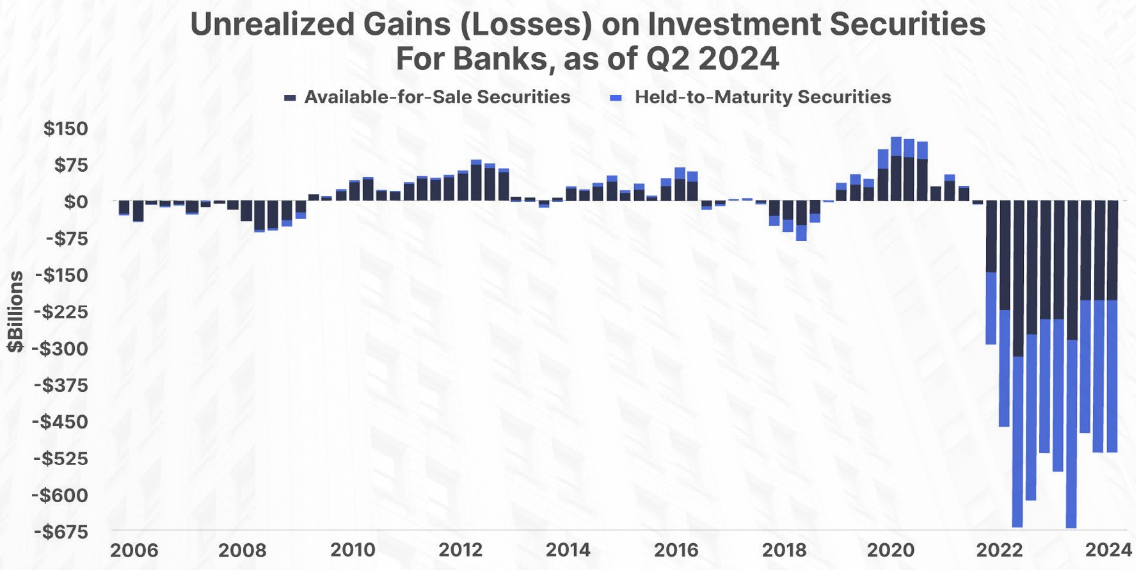
The big problem is that long-term interest rates have risen sharply since then, moving from roughly zero in 2020 to a peak of 5% in early 2024, and roughly 4.7% now.



A brief aside about how bonds work: As the yield of a bond rises, its price declines. In 2020, an investor could have paid $1,000 for a bond that yielded less than 1%. Today, that same investor can buy a bond for $1,000 that yields 4.7%.

What does that mean for all of those 2020 bonds in the market? They're worth a lot less than $1,000. If you could buy an instrument that yielded nearly five times more, why would you pay much at all for the low-yielding bond? The answer is... you wouldn't. For example, a 30-year Treasury that was issued in 2020 now trades for as little as $400.

As a result, the banks that loaded up on long-term bonds in 2020 are sitting on enormous losses... As of the end of Q2 2024, U.S. banks were sitting on $513 billion in unrealized losses from their holdings of long-duration Treasuries and mortgage-backed securities.



Source: FDIC

That's nearly 22% of the total equity capital in the U.S. banking system.

And Bank of America has more exposure than almost any other bank.

How Banks Use Bonds

Let's step back for a moment. Why do banks buy bonds in the first place?

Well, they collect deposits and need to do something with the money. They lend it... and they invest it. To encourage banks to own U.S. Treasury bonds, banking regulations consider these assets risk free. Because the assets are considered safe, banks that hold them are allowed to be highly leveraged, following complicated risk-weighted capital regulations put in place as part of the Dodd-Frank reforms, an Obama-era law enacted after the Global Financial Crisis meant to prevent excessive risk taking. The measure was implemented ostensibly to improve the financial system's accountability and transparency.

These regulations, though, completely ignore market reality – which is that any financial instrument with a fixed coupon (interest payment), like a 20+ year Treasury bond, will have an extremely volatile market price. As real yields fluctuate, investors will adjust what they are willing to pay for that instrument. This can potentially inflict huge losses on the banks, and limit their liquidity during a bank run – because if a bank can only sell a note for (say) $500 that it paid $1,000 for, it has lost 50% of the deposits that investment represents.

In short, by pretending that U.S. Treasury bonds are risk-free when they're not, the banks' biggest assets, rather than being a bulwark against market volatility, have actually become the biggest source of volatility.

Risk-weighted capital is a deeply misleading figure. The real metric to look at is how much actual equity capital a bank holds – that's the figure that tells the investor how prepared the bank is to absorb a shock, regardless of the source.

Bank of America: The Worst Investor In History

Bank of America CEO, Brian Moynihan, proves that even people in the highest positions in banking can make really dumb decisions with other people's money.

Moynihan made what may well be the single worst investment in the history of capitalism in the summer of 2020 when he bought more than $500 billion worth of "COVID bonds" – long-duration mortgages paying only about 1% a year.

As a result of this huge investment in low-yield, high-duration (15 years+) bonds, Bank of America can't afford to offer its customers interest on their deposits: Depositors are being paid just 0.01% to 0.04% on checking and savings accounts – making it very vulnerable to a run on the bank if its customers pull their money out to put into another bank offering higher interest rates on their deposits.

And even so, the bank's yield spread (that is, the difference between what it earns on its money, and what it pays depositors) is still only around 2.2%. So, if the bank offered even 1% on its deposits, its earnings would virtually disappear.

Today, Bank of America has $89 billion in unrealized losses on that bond portfolio. The bank has tangible equity (that is, real equity) of $200 billion. As rates go higher, the losses will grow. The losses on these bonds – in the not-at-all-unlikely event that it would need to sell a very significant portion of them – will bankrupt Bank of America.

These losses, and the inability of Bank of America to pay a competitive interest rate for deposits, will eventually trigger a run on the second-largest bank in America. And while no one is talking about it now, these events can happen in an instant. Once a run starts, a trickle of cash out of Bank of America can quickly escalate into a flood. In the era of smartphones and online banking, a majority of depositors could flee with their money in a matter of hours.

In fact, there isn't any logical explanation for why such a run hasn't already occurred… not when depositors can earn 4%-plus in deposit accounts at banks such as SoFi, Discover, and Goldman Sachs – or better yet, 4.50%-plus in short-term U.S. Treasuries.

This is exactly what happened in the spring of 2023 to First Republic Bank, Signature Bank, and Silicon Valley Bank, all of which owned similar bonds on their balance sheets that were very low-yielding and thus couldn't be sold without huge losses.

Yet… when Bank of America reported third quarter 2024 earnings last month, Moynihan called the results "solid," noting growth in investment banking, asset management fees, and sales and trading revenue. "I thank our teammates for another good quarter. We continue to drive the company forward in any environment."

Neither he – nor the 19-page quarterly press release – made any mention of the enormous losses in the bank's $850 billion bond portfolio.

Follow The Money

When Warren Buffett sells a significant portion of a holding, it's worth taking note.

And for the past four months, Buffett's Berkshire Hathaway (BRK) has been selling shares of Bank of America. These details are public: As of October 2024, Berkshire Hathaway had sold 260 million BAC shares at an average price of $41, for proceeds of $10.6 billion. These sales reduce Berkshire's stake in Bank of America to less than 10% – a level below which Buffett no longer has to immediately report any additional sales. Berkshire Hathaway still owns more than $30 billion worth of shares in the bank.

What nobody has figured out is whether Berkshire is going to dump its entire position. The even bigger secret is why Berkshire has sold almost all of its other bank stocks since early 2020 as well:

- Sold 100% of its 346 million shares in Wells Fargo (WFC)
- Sold 100% of its 150 million shares in U.S. Bancorp (USB)
- Sold 100% of its 60 million shares in JPMorgan Chase (JPM)
- Sold 100% of its 12 million shares in Goldman Sachs (GS)

In regard specifically to Bank of America, Berkshire invested $5 billion in the bank in 2011. This was one of the most famous "Buffett deals." Berkshire bought preferred stock that paid a 5% dividend and gave Buffett the right (but not the obligation) to buy 700 million common shares at $7.14 each. Berkshire exercised its conversion rights in 2017. And then, in 2018 and 2019, Berkshire continued buying, adding another 300 million shares at prices in the high $20 range, worth approximately $8 billion.

This was a massive move that he is now undoing. Since July 2024, Buffett has been selling as fast as the market will allow.

And he's not the only investor who sees what's coming. Ray Dalio's Bridgewater Associates (the largest hedge fund in the world) has recently dumped more than $100 million of Bank of America and virtually every bank stock in America, including: JPMorgan Chase (JPM), Wells Fargo (WFC), Goldman Sachs (GS), Morgan Stanley (MS), Bank of Hawaii (BOH), PNC Financial (PNC), Citizens Financial (CFG), and Capital One Financial (COF).

The banking sector's losses on investment securities is only part of the problem. These institutions are also sitting on an estimated $120 billion in losses from commercial real estate ("CRE") loans. Richard Barkham, chief economist at CBRE – the world's largest CRE investment firm – estimates these losses would wipe out 100% of the tier-one capital buffer at over 300 U.S. banks.

That's on top of any expected losses that would normally occur during a credit-cycle downturn. We expect record defaults in the unprecedented $5 trillion of consumer credit spanning auto loans, credit cards, student debt, and personal loans, not to mention nearly $3 trillion in commercial and industrial loans.

How A Run Happens... And What's Next

In the 12 months after the Fed started raising rates in March 2022, depositors yanked nearly $1 trillion from U.S. banks. Never before in history have we seen deposit flight on this scale.

And though deposits have recovered some of those losses since, here's the real issue: In today's world, 100% of bank deposits are only a few taps on a cell phone from heading out the door. Bank of America, due to its massive purchases of low-yielding long-term bonds, currently has an average portfolio yield of only 2.44%. There's no way that Bank of America can pay anything like short-term Treasury yields in excess of 4.5%.

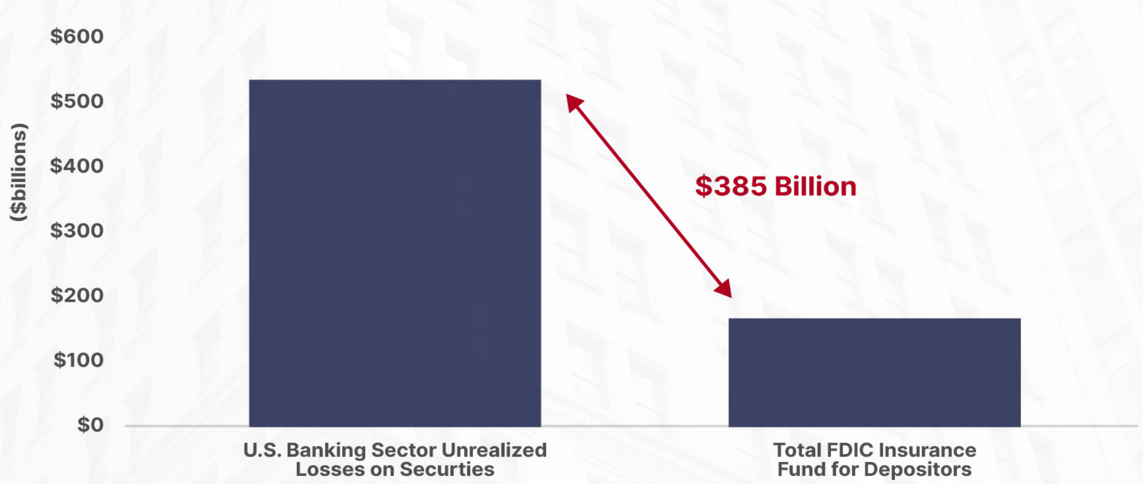
Thus… it is only a matter of time before depositors take notice. They're not being paid anything like a fair rate of return. And, Bank of America is, mostly likely, already insolvent. The only thing that's keeping Bank of America alive is that no one has noticed this situation yet.

That and… the FDIC. Without the protection of the Federal Deposit Insurance Corporation, Bank of America would, mostly likely, collapse tomorrow. That's because it has a huge hole in its balance sheet that the U.S. government is allowing it to fudge.

All those people with accounts at Bank of America might say: I'm not worried because Bank of America is too big to fail. And the FDIC will pay back depositors, right?

Yes… perhaps. But the FDIC is dramatically underfunded compared to the unrealized losses on U.S. banks' balance sheets.

U.S. Banks Unrealized Losses vs FDIC Depositor Insurance Fund



So the FDIC will undoubtedly need more money. And the Federal Reserve will always backstop the banks, no matter how poorly run they are… how greedy their managers are… or how absurd their risk-management policies are. And when that happens, who pays the bill?

You do… I do… as more money-printing generates more inflation… continues to run up the federal debt… and, **as we've written before**, slowly erodes the fabric of American society.

When a run happens, it won't take days or weeks. It will take hours. A run on Bank of America could spark panic in other banks too, of course. The end result will lead to yet another national bailout of the banks.

And that will drive inflation far, far higher. It will also panic the stock market... which now sits at a record high.

Action to Take: Short shares of Bank of America (NYSE: BAC) above $45, with a stop loss at $60 per share

For readers who aren't familiar with shorting shares, the process is very similar to buying shares, except the orders are reversed: you sell to open the trade, and then buy to close.

The first step is to ensure you have the trading permissions from your brokerage provider, including the option to make short sales, as well as margin borrowing capabilities. Once you have these trading permissions, most brokerage platforms will have a field where the user will input the ticker symbol of the company, and an option to "sell short" or "sell to open" for initiating the short sale. When the time comes to exit the trade, you will then "buy to cover" or "buy to close" the short position.

Porter & Co.
Stevenson, MD

P.S. If you'd like to learn more about the Porter & Co. team, you can get acquainted with us **here**. You can follow me (Porter) on **X** here: **@porterstansb**