Week in Review

Equity Markets:

This week will mark the one-year anniversary of the start of the Fed's historic rate hiking campaign. The repercussions of the campaign have been slow to reveal themselves and the first major crack may have been exposed last week. The S&P 500 ended the week down 4.5% and the final trading days of the week saw steep sell-offs in reaction to the Silicon Valley Bank news. Market sentiment plunged with concerns around whether SVB is an isolated incident or other regional banks could start to faulter.

Clients of Silicon Valley Bank withdraw billions of dollars overnight just as the bank was attempting to shore up its balance sheet. The California banking regulators withdrew the bank's charter and placed control in the hands of the FDIC before any more damage took place. On Sunday, the Fed and the FDIC established an emergency funding facility that involved backing 100% of depositors' SVB accounts, despite roughly 90% of the bank's accounts being above the FDIC limits[1]. Another surprise occurred Sunday, with New York banking regulators closing Signature Bank. Regulators state potential "systemic risks"[2], as the main factor in the closing.

Fixed Income Markets:

The negative correlation benefits that have historically defined high-quality fixed income finally returned. Despite the hawkish tone from Chairman Powell during his testimony to Congress, strong job reports, and a futures market that continued its climb upward in the Fed Fund's Rate, the 10-year Treasury yield cratered 0.3% to end the week at 3.7%. The Bloomberg Agg Bond Index finished the week in the green by 1%.

The concerns around Silicon Valley Bank caused a "run to quality." During these times of market dislocations, the historical trend has been for investors to take refuge in safety assets like the US Treasury. Even in the face of another rate hike next week, the bond market rallied. The events that occurred last week are a perfect example of the benefits of a diversified portfolio. The markets can pivot at any given moment and the once most-hated allocation in a portfolio can quickly turn into the anchor.

Economic:

The labor market remained strong during February. Non-farm payrolls increased by 311,000, handily beating the Dow Jones estimate of 225,000. The unemployment rate increased slightly to 3.6% showing signs that we may have already witnessed the peak strength. Wage growth increased 0.2% month-over-month, in line with estimates. The JOLTS report from earlier in the week showed that job openings outnumbered available workers by nearly two to one. The labor market is a key input for monetary policy and despite a historical rate hiking campaign, the labor market remains stubbornly resilient.

Looking Ahead

Equity Markets:

The events of last week were significant and should be a reminder for investors, and policy makers, of the sensitivity of the environment we are currently in. Rate hiking cycles have historically ended with a recession. Policy makers must walk a fine line and execute their plan perfectly to avoid creating cracks in the economy. The first crack was likely exposed last week, and the question all investors are asking is: "Was this an isolated event?". This is a fluid situation. It may not be isolated, but it could be concentrated within a sector. Silicon Valley Bank had a client base comprised of technology start-ups and Signature Bank had a heavy presence in the cryptocurrency industry. 2022 was a year where growth companies and risk assets were hit the hardest. A high concentration in those sectors and lack of operational discipline appear to be the main contributors of the sudden weaknesses for these banks.

Sentiment plummeted Thursday and Friday during the sell-off. As investors, all we can do is take in the available information and have a plan. The market is still down ~20% from its all-time high in January of 2022, we are in the midst of earnings revisions, and sentiment is trending negative. If you were to ignore the headlines of last week, the environment is one where the potential for long-term opportunities arises. This is why having a thoughtfully developed, diversified investment plan is essential during times of heightened volatility. Committed investors have historically been rewarded for staying invested, and we believe that holds true today.

Fixed Income Markets:

In a matter of weeks, the bond market has experienced substantial volatility. The 10-year treasury yield spiked to 4% from the early February levels of 3.3%, followed by the most recent descent back to 3.7%. Throughout this time, the inflationary picture has not been positive and concerns of a higher rate environment continued to increase. Despite these factors, the bond market has remained below its cycle high in yield which occurred in October.

We find it unlikely for a retest of the 10-year yields high of 4.25%. The Fed may still need to raise rates, but most of their work took place last year. The upward pressure in rates from policy is likely to be offset with weakening economic conditions which has historically led to investors driving the price of bonds up and yields down.

Economic:

This week will likely be filled with headlines on the banking system, but we will also have a business economic calendar with very important inputs for monetary policy. February's CPI and PPI reports will be released ahead of the next FOMC meeting taking place the 21st and 22nd. The preliminary read on the University of Michigan Consumer Index for March has the potential to reveal timely insights into the consumer following the events of last week.

**** *See Important Disclosures on following page*

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Sources:

1)Reuters
https://www.reuters.com/business/finance/regulators-urged-find-silicon-valley-bank-buyer-industry-frets-about-fallout-2023-03-12/

2)Reuters
https://www.reuters.com/business/finance/new-york-state-regulators-close-signature-bank-2023-03-12/

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