CROSSMARK GLOBAL INVESTMENTS

Doll's Deliberations

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SUMMARY:

Equities had their worst week since September (S&P 500 -4.6%). All sectors were down with banks the biggest decliners due to the SIVB financial failure. Treasuries rallied across the curve, with two-year yields recording their largest two-day move since 9/11. Best sector performers for the week were consumer staples (-1.9%), utilities (-2.9%), and technology (-3.1%). Worst performers were financials (-8.5%), materials (-7.6%), and REITS (-7.0%).

KEY TAKEAWAYS:

1. "Economic data have come in stronger than expected, which suggest that the ultimate level of interest rates is likely to be higher than previously anticipated." "The process of getting the inflation level down to 2% has a long way to go and is likely to be bumpy."
   – Fed Chair Jerome Powell, March 7, 2023

2. In reaction to Powell's testimony, the U.S. two-year yield jumped 12bps and the 2/10 spread inverted even further, hitting its most negative level since 1981. By week's end, this had more then reversed due to the bank turmoil. (The recent market pricing for peak Fed funds topped out at 5.80% early in the week but fell to 5.25% by week's end.)

3. Job growth in February was a strong 311,000. Job growth is still too strong to assume labor markets have stopped tightening. Some relief came from an average hourly earnings increase of 0.2% (rather than 0.3% as expected).

4. The banking (and market) volatility surrounding the collapse of Silicon Valley Bank is likely to lead to more stringent capital requirements. It is too early to tell whether or not significant contagion to other financial institutions or technology start-ups will occur.

5. The KBW bank index has dropped approximately 12% in the last three days, a pattern seen in five other bear markets. In other episodes, a significant rally was seen in the S&P 500 over the next month, followed by lower lows.

6. Every tightening cycle has been associated with a financial shock (a "bump in the night"). Here is a reminder of some past shocks: 1984 – Continental Illinois, 1998 – LTCM, 2012 – Eurozone crisis. One wonders if SIVB will make the list.

7. The Fed funds rate has historically exceeded the level of CPI before the conclusion of the tightening cycle. Currently, inflation is running more then 150bps higher than Fed funds.

8. REMINDER: a recession has followed seven of the last nine tightening cycles. Recessions have started on average 14 months after the yield curve inverted. (We are 11 months into this inversion.

9. Some investors are contemplating the possibility of a "no-landing" scenario in which case the Fed can ease inflationary pressures without tipping the economy into a recession. According to Strategas, this is a central bank equivalent of pulling a royal flush, i.e., not likely.

10. President Biden rolled out his proposed FY 2024 budget, including dead on arrival provisions such as a 28% corporate tax rate, double taxing of U.S. foreign source profits, and an unrealized capital gains tax on the wealthy.

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	-4.35%	-3.24%
S&P 500	-4.51%	0.92%
NASDAQ	-4.68%	6.63%
RUSSELL 2000	-5.24%	3.95%
RUSSELL 1000 GROWTH	-4.23%	4.63%
RUSSELL 1000 VALUE	-5.50%	-2.33%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	-4.10%	7.40%
CONSUMER DISCRETIONARY	-5.49%	6.98%
CONSUMER STAPLES	-1.89%	-4.52%
ENERGY	-5.30%	-5.73%
FINANCIALS	-8.46%	-3.70%
HEALTHCARE	-3.90%	-8.63%
INDUSTRIALS	-4.43%	0.88%
INFORMATION TECHNOLOGY	-3.05%	9.22%
MATERIALS	-7.61%	0.65%
REAL ESTATE	-6.88%	-2.31%
UTILITIES	-2.81%	-8.66%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	-2.33%	3.43%
MSCI ACWI EX U.S.	-0.96%	4.75%
MSCI EAFE	-0.25%	6.51%
MSCI EM	-1.97%	1.39%

INFLATION FIGHTING, RECESSION UNCERTAINTY, AND NOW, CREDIT CRUNCH CONCERNS

Fed Chair Powell was hawkish in his comments to Congress last week. Thankfully, bond investors have not panicked, nor have equity and credit markets nosedived despite the hawkish pivot. There remain entrenched hopes among both investors and central banks that inflation will eventually recede to low levels without a monetary knock-out blow and full-blown recession. We remain dubious.

The recent firming in long-term government bond yields has halted for the moment, encouraged somewhat by a further surge at the short end of the yield curve and choppier equity market action. We envision outright tight monetary conditions and a recession as the inevitable outcomes, even if the timing is still uncertain and not imminent. The ever-deepening yield curve inversion led by the U.S. is ironically providing economic support, or at least is muting some of the drag from policy rate hikes. Perhaps the Fed fears that lifting its estimated equilibrium rate might shatter entrenched expectations and trigger a riot in the Treasury market. At a minimum, we would bet that there is considerable uncertainty among Fed officials about whether the longer-term equilibrium policy rate is meaningfully higher.

The U.S. labor market and wage trends remain historically quite robust. No doubt the ongoing layoffs (albeit still mostly layoff announcements) in former high-flying pandemic beneficiaries will cause payroll growth to slow in 2023. However, the overall job picture, including historically low current unemployment claims, remains in good shape and is not consistent with an approaching recession. Recessions typically develop once the business sector sees poorer profit results/prospects and slows or stops hiring; then as demand growth weakens, companies cut payrolls and capital expenditures.

NOTE: Fears about the health of the U.S. bank securities' portfolios surged last in the week. While it is too early to conclude, our view is the large unrealized losses on bond holdings do not threaten a liquidity crunch in the banking system because few banks will be forced sellers.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	0.01%	0.29%
BLOOMBERG U.S. CORP HIGH YIELD	-0.62%	2.16%
BLOOMBERG U.S. GOV/ CREDIT	0.02%	0.33%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.07%	0.80%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-3.86%	1.02%
COMMODITIES (DJ)	-3.38%	-6.48%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	-3.01%	9.52%
CURRENCIES (DB G10 CURRENCY FUTURE)	0.00%	1.78%

CONCLUSION:

We are nervous that the recent period of relative stability will end in the coming months. That the financial markets are muting the economic drag from tightening, monetary policies will help prolong the cycle, but will not prevent the inevitable endpoint. We will monitor any fallout from the Silicon Valley Bank situation.

Data from Bloomberg, as of 3/10/2023.

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