CROSSMARK
GLOBAL INVESTMENTS

Doll's Deliberations

Weekly Investment Commentary | March 20, 2023 | Issue 3.12

SUMMARY:

U.S. equities were mixed (S&P 500 +1.4%) in a week dominated by headlines around banking uncertainties. The market was whipsawed by evolving concerns about the banking industry following the regulatory shutdown of Silicon Valley Bank on Friday, March 10. Best sectors were communication services (+6.9%) and technology (+5.7%); worst sectors were energy (-7.0%) and financials (-6.1%).

KEY TAKEAWAYS:

1. We have warned often in our weekly commentaries that there are consequences to raising interest rates at the fastest pace in U.S. history (0% to 4½% in less than 12 months). Every tightening cycle has experienced a credit or liquidity problem ("bump in the night"). Examples are: Continental Illinois – 1984, LTCM – 1998, Eurozone Crisis – 2012. Now, Silicon Valley Bank – 2023.

2. The Fed and FDIC acted swiftly to contain the SVB debacle. We think the regulators' actions will work and this won't set off a credit crunch. But it will help slow economic and employment growth.

3. An important and uncertain Fed meeting will occur this week. In light of financial markets, 50bps is off the table. To do nothing could signal the Fed is finished raising rates and/or there is something they "know" that will scare the public. 25bps seems like the right answer.

4. We believe the ongoing impact of what the Fed has already done (massive rate increases from zero to 4½% in one year) is more important than whether or not the Fed raises rates or not later this week.

5. While the Fed's tightening cycle is close to finished, the FOMC will need to see much more evidence of falling inflation and slower economic growth before it considers rate cuts. Is it possible that the Fed may be too loose for the economic data while simultaneously too tight for the banking system?

6. The eleventh straight month of falling Leading Economic Indicators (LEI) point to slowing growth and an eventual recession. Bank failures are often a "canary in the coal mine" warning that a U.S. recession is more imminent than most economists anticipate.

7. The U.S. CPI rose +0.4% m/m (6.0% y/y) and the core CPI was +0.5% m/m (5.5% y/y) in February. The U.S. labor market does not appear to have rolled over enough to remove concerns about wage inflation yet.

8. Bond volatility has surged to the highest level since 2009 and is amplifying stresses across credit and rates markets. This has driven an abrupt shift in Fed rate path expectations.

9. The rally from October was just another bear market rally that ultimately faded. The end of bear markets are typically punctuated by an event that accelerates the market's pricing of the true downside in earnings. We have not seen that yet.

10. As we have been positing for quite some time, we still believe in front of us is a mild recession, "the" bear market low, and then, yes, eventually a new bull market.

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	-0.11%	-3.35%
S&P 500	1.47%	2.41%
NASDAQ	4.44%	11.36%
RUSSELL 2000	-0.01%	0.88%
RUSSELL 1000 GROWTH	4.12%	8.94%
RUSSELL 1000 VALUE	-1.64%	-3.92%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	6.94%	14.85%
CONSUMER DISCRETIONARY	2.37%	9.51%
CONSUMER STAPLES	1.39%	-3.19%
ENERGY	-6.92%	-12.26%
FINANCIALS	-6.04%	-9.52%
HEALTHCARE	1.37%	-7.38%
INDUSTRIALS	-2.44%	-1.58%
INFORMATION TECHNOLOGY	5.67%	15.42%
MATERIALS	-3.41%	-2.79%
REAL ESTATE	0.41%	-1.91%
UTILITIES	3.96%	-5.04%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	0.58%	2.71%
MSCI ACWI EX U.S.	-2.45%	1.33%
MSCI EAFE	-3.06%	2.71%
MSCI EM	-1.35%	-1.32%

THE PLOT THICKENS AND GETS MORE TREACHEROUS

For many investors, the failure of Silicon Valley Bank and the knock-on effect it has had on bank stocks has triggered memories of the Global Financial Crisis. Swift action by policymakers and regulators has been designed to protect all deposits at any failing bank. As a result, the large unrealized losses on the bonds held by banks do not threaten a liquidity crunch in the banking system. The nature of today's bank losses is quite different than the 2008 crisis, and is not related to economic problems and deteriorating credit.

Nevertheless, investors are shaken and prone to panic. While fear and panic creates a proclivity to spend less, the economy now has lower borrowing rates, a reversal of some of the paper losses on government bonds, lower energy prices and a near-certainty that the Fed and other central banks will slow their inflation fighting rate increases.

The ECB hiked rates last week (50bps) and, while the odds have declined, even the Fed may vote for a 25bps hike next week. However, the hawkish rhetoric of recent months will be gone until after the banking dust settles. If policymakers did not intervene and provide open-ended backstops in the past week, then a deflationary outcome could have occurred. Central banks learned the lesson of 2008 by acting quickly and provided open-ended protection for depositors (but not shareholders). Even with the latest developments in the banking sector, the Fed's policy mandates would be best served by staying the course and raising the policy rate (we think that a 25bps hike next week remains more likely than not), while using verbal guidance and regulatory measures to address lingering concerns in the banking sector. Assuming confidence in the banking sector is soon restored, we think that the Fed will hike the policy rate to 5-5.25% and hold it at that level through year-end.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	0.59%	2.05%
BLOOMBERG U.S. CORP HIGH YIELD	-0.28%	1.58%
BLOOMBERG U.S. GOV/ CREDIT	0.44%	2.06%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.12%	0.93%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	1.91%	-0.52%
COMMODITIES (DJ)	-1.78%	-8.14%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	-2.13%	2.31%
CURRENCIES (DB CURRENCY FUTURE HARVEST)	0.46%	1.29%

The financial markets will continue to be volatile and prone to risk-off until "shoes stop dropping," as investors are fearful of further contagion. While we expect these events will slow economic growth somewhat (and therefore do some of the work for the Fed), we do not envision meaningful economic fallout from what were unique conditions for a few banks. The rapid end of the free money era (Fed raising rates an historic 4 ½% in twelve months) and massively accommodative fiscal policies was bound to unleash a "bump in the night", and generate difficult transitional problems for all sorts of asset markets. Thus, from a longer-term perspective, investors should be prepared for periodic eruptions during the transition to more normal policies. Risk-off could persist in the near term until investors shift from indiscriminate dumping to looking for opportunities amidst the panic. Thereafter, a rebound seems likely and we would look to play such a shift, at least until government bond yields and policy rates resume their cyclical advance. We are still cyclically cautious as the inflationary backdrop is not going to end without some real economic pain (probably a mild recession).

CONCLUSION:

The risk-off backdrop could persist in the near term, until banking fears start to subside. Policy steps to backstop banking systems are occurring and should succeed. We believe the bond market's dovish rate cut bets are an overreaction and will unwind as contagion concerns in the banking sector ease up further. Economic growth is likely to continue to downshift as further impact from what the Fed has already done (0 to 4 ½% Fed funds in twelve months) is felt.

Data from Bloomberg, as of 3/17/2023.

Crossmark Global Investments, Inc. (Crossmark) is an investment adviser registered with the Securities and Exchange Commission that provides discretionary investment management services to mutual funds, institutions, and individual clients. Investment advice can be provided only after the delivery of Crossmark's firm Brochure and Brochure Supplement Form ADV (Parts 2A and 2B) and Form CRS, and once a properly executed investment advisory agreement has been entered into by the client.

All Investments are subject to risks, including the possible loss of principal. Past performance does not guarantee future results.

Information and recommendations contained in market commentaries and writings are of a general nature and are not intended to be construed as investment, tax or legal advice. These materials reflect the opinion of Crossmark on the date of production and are subject to change at any time without notice. Where data is presented that was prepared by third parties, the source of the data will be cited, and we have determined these sources to be generally reliable. However, Crossmark does not warrant the accuracy of the information presented.

This content may not be reproduced, copied or made available to others without the express written consent of Crossmark.

DD-WKLY-COMM-3.12 03/23