CROSSMARK
GLOBAL INVESTMENTS

Doll's Deliberations

Weekly Investment Commentary | March 27, 2023 | Issue 3.13

SUMMARY:

U.S. equities were higher last week (S&P 500 +1.4%). Last week's gains came despite volatility in Treasuries due to the Fed meeting and ongoing global bank turmoil. While the yield curve steepened somewhat, recession signaling continued. Best sectors were communication services (+3.4%) and energy (+2.3%); worst sectors were REITs (-1.4%) and utilities (-1.2%).

KEY TAKEAWAYS:

1. The Fed raised the Fed funds rate by 25bp to 4.75-5.00% assuring, "the U.S. banking system is sound and resilient." The dot plots and Powell's language suggest one more 25bp hike may yet occur.
2. The key language change in the Fed's release last week was that "the Committee anticipates that some additional policy firming may be appropriate." (Last month's read "ongoing increases in the target range will be appropriate.")
3. In order to counter financial instability, the Fed has temporarily allowed its balance sheet to expand implying that liquidity is once again expanding.
4. Perhaps obvious, but is important to note that interest rates have been a bigger problem than credit risk for the banking system.
5. The banking crisis increases the probability of a recession (for us, from 60% to 70%) due to further restrictions in financial conditions.
6. The decline in bond yields is largely the result of a worsening economic growth outlook, which probably means earnings estimates will be under additional pressure.
7. Problems that still exist include: uninsured deposits leaving small and regional banks, continued yield curve inversions, historically weak money supply, recessionary leading economic indicators, and tightening bank lending standards.
8. Central bank policy expectation changes have caused interest rate differentials across countries to move in an unfavorable direction for the dollar.
9. The Fed will continue to have its work cut out for it in simultaneously dealing with higher inflation and the banking crisis.
10. Prior to the banking crisis, credit spreads were reasonably tight. While they have widened some, we expect further widening prior to the onset of any recession.
11. First quarter earnings are only a few weeks away with expectations of -5% earnings growth. (Notably, financials are expected to grow earnings 6%.)
12. Historically, stocks have been mixed as the Fed engineers peak Fed funds. Conversely, stocks tend not to do well when the Fed begins cutting rates, as that is the period when earnings estimates tend to fall the most.

EQUITY MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
DJIA	1.18%	-2.21%
S&P 500	1.41%	3.86%
NASDAQ	1.68%	13.22%
RUSSELL 2000	-0.32%	-2.02%
RUSSELL 1000 GROWTH	1.64%	10.73%
RUSSELL 1000 VALUE	1.00%	-2.96%

S&P EQUITY SECTORS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
COMMUNICATION SERVICES	3.40%	18.76%
CONSUMER DISCRETIONARY	0.44%	9.99%
CONSUMER STAPLES	1.58%	-1.66%
ENERGY	2.29%	-10.25%
FINANCIALS	0.58%	-9.00%
HEALTHCARE	1.51%	-5.97%
INDUSTRIALS	0.67%	-0.92%
INFORMATION TECHNOLOGY	2.07%	17.80%
MATERIALS	2.16%	-0.69%
REAL ESTATE	-1.30%	-3.19%
UTILITIES	-1.16%	-6.14%

INTERNATIONAL EQUITY MARKETS (INDEX NET RETURN)	LAST WEEK	YEAR-TO-DATE
MSCI ACWI	1.69%	3.82%
MSCI ACWI EX U.S.	3.01%	4.58%
MSCI EAFE	3.32%	6.05%
MSCI EM	2.79%	2.53%

A WEEK OF STABILIZATION BUT UNCERTAINTIES REMAIN

Global risk assets struggled to recover last week, still fearful of more banking problems, yet encouraged by the prompt and aggressive actions taken by policymakers and regulators. The recent "bump in the night" was a clear reminder that the unwinding of the free money era will generate problems in areas where excesses and asset bubbles developed, including in the Treasury market. A lasting calm, or better yet a positive environment for risk assets is unlikely until, and unless, the threat of restrictive monetary policies end. That awaits a return to low core inflation, which is not likely anytime soon.

The irony of the Silicon Valley Bank collapse was that the catalyst for its demise was an economy that has been too strong for too long, causing the Fed to lift its policy rate faster and longer than the consensus expected. The bank's problems were many, but unlike most prior bank failures it was not caused by a poor U.S. economy, deteriorating credit quality and defaults, etc. That said, normalizing monetary conditions after a period of being far too lax will always generate problems wherever there are excesses and vulnerabilities, such as the current backdrop.

The net economic impact of recent events should be limited, but sentiment might weaken, causing some tentativeness in several key economic variables. Smaller U.S. banks might turn conservative but the banking system as a whole has a very low loan-to-deposit ratio and large banks are unlikely to further scale back lending. We remain cyclically cautious as the rate-hiking cycle has more to run.

The Fed will be less keen to take economic risks in the near run as a consequence of the banking crisis. The FOMC was notably less hawkish last week forecasting only one more rate hike this year, which we expect will eventually be reversed higher as inflation remains unacceptably high. Interest rates have eased in the past two weeks, while equity markets have taken a hit since SVB failed, but stabilized last week. Lower interest rates, less hawkish central banks and weak global energy prices will provide some economic offsets to any upcoming tightening in credit conditions. In the end, sticky core inflation may force monetary conditions to become restrictive, and trigger further risk asset weakness. Consequently, we remain cyclically cautious.

FIXED INCOME MARKETS (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
BLOOMBERG U.S. AGGREGATE BOND	0.46%	3.38%
BLOOMBERG U.S. CORP HIGH YIELD	0.69%	2.14%
BLOOMBERG U.S. GOV/ CREDIT	0.48%	3.41%
BLOOMBERG U.S. T-BILL 1-3 MONTH	0.08%	1.04%

ALTERNATIVES (INDEX TOTAL RETURN)	LAST WEEK	YEAR-TO-DATE
REAL ESTATE (FTSE NAREIT)	-3.58%	-6.28%
COMMODITIES (DJ)	0.51%	-7.67%
GLOBAL LISTED PRIVATE EQUITY (RED ROCKS)	3.88%	4.13%
CURRENCIES (DB CURRENCY FUTURE HARVEST)	-1.07%	0.21%

CONCLUSION:

Sentiment cold be fragile in the near term due to fears of additional bank failures. However, the authorities in the major economies will aggressively ringfence banking problems and ultimately will protect depositors. Central banks have tempered their hawkish rhetoric, which should soon calm nerves and allow the risk-on phase to resume. Barring additional significant banking turmoil, we expect the Fed to raise rates 25bps in May, followed by a pause, but think a reduction before year-end is unlikely. The Fed needs to thread the needle between fighting inflation and keeping from sending the economy into recession. Overall global economic activity will firm and underlying inflation will be sticky. Our investment stance remains cautious, due to likely economic weakness in the near term and the requirement for further monetary tightening later on.

Data from Bloomberg, as of 3/24/2023.

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.