The Weekly Market Update – 3/13/23: Fed Response Calms Immediate Market Fears

Major Indices (Price Returns)	Close	Last Week	Quarter-to-Date	Year-to-Date	Trailing 12-Months	All-Time High	% to High
S&P 500	3,861.59	-4.55%	0.58%	0.58%	-11.71%	4,796.56	24.2%
Dow Jones Industrial Average	31,909.64	-4.44%	-3.73%	-3.73%	-5.85%	36,799.65	15.3%
NASDAQ Composite	11,138.89	-4.71%	6.42%	6.42%	-19.00%	16,057.44	44.2%
Russell 2000	1,772.70	-8.07%	0.65%	0.65%	-13.45%	2,442.74	37.8%
MSCI EAFE (USD)	2,052.22	-0.89%	5.57%	5.57%	-5.82%	2,398.71	16.9%
MSCI Emerging Markets (USD)	955.28	-3.31%	-0.12%	-0.12%	-18.44%	1,444.93	51.3%
Bloomberg Commodity Index	104.55	-3.47%	-7.32%	-7.32%	-8.73%	237.95	127.6%
Barclays U.S. Aggregate Bond	89.82	1.18%	1.05%	1.05%	-10.94%	112.07	24.8%

Source: FactSet

News Sunday that the U.S. Federal Reserve Bank (Fed) will protect the deposit base of U.S. depository institutions has calmed equity markets, although the bank sector remains under pressure. Facing a potential banking industry liquidity crisis that could arise in the wake of the collapse and government takeover of California-based SVB Financial (SIVB), the Fed announced a new Bank Term Funding Program (BTFP). The BTFP allows banks to borrow funds (pledging collateral) that may be needed to satisfy customers withdrawing funds. This reassures the public that funds are available upon demand and should reduce the need for banks to sell fixed income securities at a loss to meet withdrawal requests. The widely followed, large-company S&P 500 equity index declined 4.5% last week, erasing most of the January gain, and holding a 0.6% gain (not including dividends) in 2023 through 3/10/23. The index declined a modest 0.2% on Monday, largely halting intense selling pressure that was building late last week. Monday S&P 500 sector gains were led by Real Estate and Utilities, likely driven by a rapid decline in interest rates, making dividend yields on stocks relatively more attractive. Although the BTFP has calmed the broad U.S. equity market, the S&P 500 Financials sector (banks, insurance, and financial services companies) dropped 3.8% Monday, following last week's decline of 8.5%. While the U.S. banking industry is considerably more capitalized than it was prior to the Global Financial Crisis in 2008, and large banks are subjected to an annual Federal Reserve "Stress Test", the rapid increase in U.S. interest rates has perhaps created some cracks in the system. Investors have become cautious regarding banks with a deposit base that includes a large percentage of uninsured deposits (up to $250 thousand per account holder). In addition, investors are concerned that some bank investment portfolios may be sitting on large unrealized losses, and finally, bank lending operations could impose more conservative underwriting guidelines in the current environment. We believe that equity investors should remain invested in high-quality, leading companies, many of which are able to gain share and become stronger during times of economic uncertainty. Maintain equity portfolios that are broadly diversified across sectors including exposure to defensive sectors such as Consumer Staples, Health Care and Utilities.

U.S. interest rates have dropped significantly in response to the bank crisis, reflecting changes in the economic and Federal Reserve Bank (Fed) policy outlook. In less than one week, the U.S. 2-year Treasury yield (a proxy for short-term interest rates) has dropped to 3.99% (3/13/23) from 5.06% (3/8/23), and the U.S. 10-year Treasury yield (a proxy for long-term interest rates) over the same period has dropped to 3.54% from 3.98%. In our view, this reflects a re-emergence of U.S. recession (defined as a significant decline in economic activity spread across the economy) fears, perhaps creating challenges for equity prices over the near-term. On the other hand, expectations for ongoing Fed interest rate hikes have moderated, with even a 0.25% hike to the overnight fed funds target rate at the 3/22/23 Fed meeting uncertain at this time.

As financial markets assess the full impact of the sudden banking crisis, investors are also watching a key inflation report. On 3/14/23, the Bureau of Labor Statistics will release its measure of consumer inflation, the consumer price index (CPI). The FactSet consensus estimate for February CPI is an increase of 6.0%, an improvement from 6.4% in January. Core CPI (excludes energy and food) is estimated at 5.5% vs. 5.6% in January.

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