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Economic Indicators | April 2023 | By Kim W. Suchy

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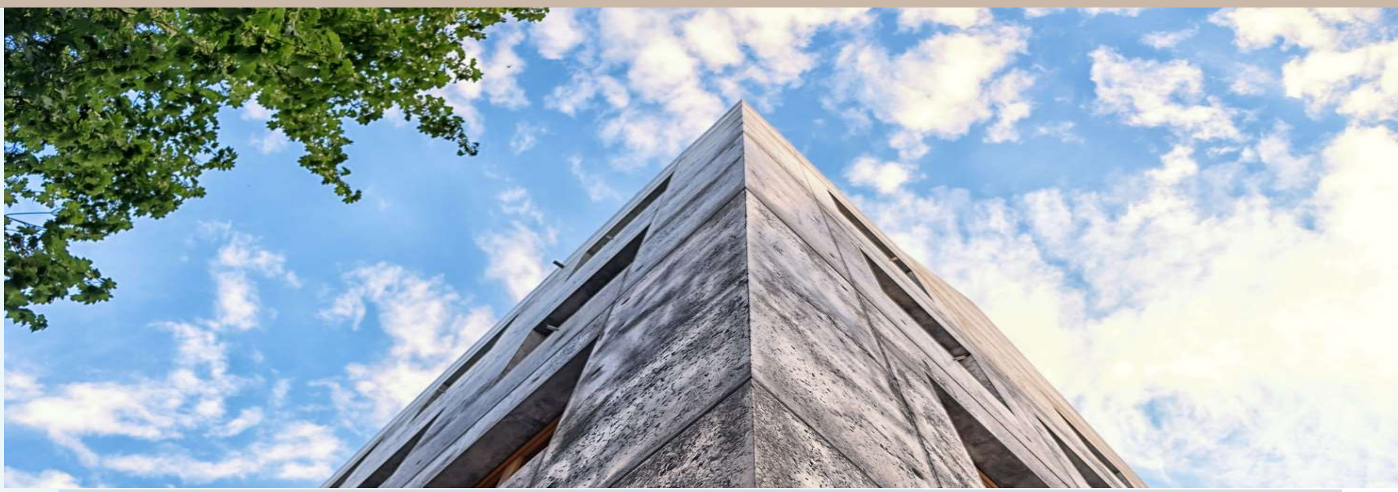


The Fed and Chairman Powell got some help with their tightening policies this past month. With inflation starting to show signs of slowing and economic growth somewhat subdued, many economists believed the Fed may have been close to ceasing its series of rate hikes. Then came the failures of Silicon Valley bank (SVB), and days later, Signature Bank, that set off a pervasive loss of investor confidence in the banking sector that beat up stocks, particularly financials, and fanned fears of a financial crisis (circa 2008-09).

The impact of the failures has served to slow credit activity and narrowed profit margins at banks as reserve collateral and deposit insurance costs are now both elevated. Some say this the credit tightening stemming from the bank failures served as the tightening equivalent of an additional 50bps rate hike.

The broader markets (non-financials) suffered some indigestion upon the failure announcements yet as we closed in on month-end, markets realized that the crisis was contained and that regulators acted quickly and effectively enough to stem the tide. Financials, on the other hand, have had a tough time recovering perhaps out of fear that margin compression would be extensive considering increased regulation.

So, getting to the crisis issue at hand, what was the catalyst? Silicon Valley Bank (SVB)'s deposit base was primarily in tech and health care startups. As deposits grew over the last few years SVB officials invested the monies into Treasuries and Govt. Agencies; generally, zero default risk. However, as the Fed implemented a series of rate hikes over the last year, the value of the existing bond portfolio declined rapidly. As interest rates rise, bond prices fall and the longer the maturity, the more pronounced the decline. SVB maintained long term bonds in order to capture yield so the rate hikes generated large bond losses.

While the bond portfolio was declining, many depositors at SVB were withdrawing deposits due to various macro issues and liquidity needs surrounding their tech and health care businesses. The combination of withdrawals and portfolio losses forced SVB to sell bonds at a pronounced loss. As the bank sought to raise $2b to accommodate withdrawals, other depositors caught wind of this and rushed the bank and attempted to withdraw $42B. SVB was insolvent, and this failed the bank and SVB became the 2nd largest bank failure in history.

Signature Bank experienced a similar failure and was closed. At the time of this writing bank examiners and regulators are evaluating the construct of these failures and near failures and are designing and implementing additional depositor safeguards to preserve the competitive nature of the banking system.

Here is your look at developments in the global marketplace.

POSITIVE DEVELOPMENTS

- In China, the PPI moved deeper into negative territory falling 1.4% in February. This is good news for inflation in the US as Chinese produced product often serves as key production input for U.S. manufacturing. Source Daily Shot.

- New home sales increased for a 3rd consecutive mo. as the homebuilding sector shows signs of recovering following last year's rise in mortgage rates. The Mortgage Bankers Assoc., average 30-year fixed mortgage rates currently sit at 6.48%, over 20 bps lower compared to the last week of Feb.

- Gold has been a sound performer YTD with various gold ETF's providing returns north of 9%. That's a reflection of lower bond yields, the possibility that the Fed is approaching the end of its rate hikes, and risk-off sentiment since Silicon Valley Bank's collapse.

    - Note, foreign investors sold $36.6B of Treasuries, according to Citigroup data, the 4th mo. of outflows over the past five. And while the actual dollar amount has risen 6.8% since the end of 2019, the percentage of U.S. government debt held by foreigners has fallen to 29.3%, from 39.2% at the end of 2019. Gold has been a beneficiary of the sale proceeds as central banks are buying gold.

- In looking at the recent inflation data, the Fed seems to finally have room to pause. Currently, the Fed Funds Rate is now above Core PCE (the Fed's preferred measure of inflation), which suggests that monetary policy is now entering a contractionary stage….*after 9 hikes, it should be*!
    - A second reason to believe a contraction is coming is due to the newly formed stressors in the banking system stemming from issues related to SVB.

- The Conference Board reported a slight improvement in U.S. consumer confidence in the month of March. The report shows that consumer confidence index inched up to 104.2 in March from an upwardly revised 103.4 in February.

NEUTRAL DEVELOPMENTS

- Housing construction showed signs of life in February, rising for the first time in 6 mos. and coming in higher than most forecasts. Starts increased 9.8% in February but are down 18.4% versus a year ago. New building permits increased 13.8% in February but are down 35.5%. Existing home sales increased 14.5% in February yet remain 22.6% below last year's level. Last month represented the first rise in 13 mos. *One month does not make a trend but stabilizing interest rates may help boost the annual slowdown.*

- According to Bloomberg, the week of the SVB collapse, over $100B went into money market funds and out of bank deposits. *We have witnessed this activity as well as more monies flowing into short Treasuries.*

- TD economics reports that large parts of the global economy are showing signs of a modest rebound after a sharp slowdown at the end of 2022, but the improved outlook is threatened by stubbornly high inflation and banking strains in the U.S. and Europe. Business surveys published late last week noted pickups in activity across Europe that were driven by services providers, while Japan saw a similar pick up aided by the arrival of tourists from China after the lifting of C19 restrictions.

- CPI inflation continues to come down, albeit slowly. Food prices are still increasing, but energy has normalized somewhat, helping reduce overall pressures. The biggest contributor to inflation last mo. was shelter, which comprises 1/3 of the overall index and was up 0.8% for the mo.

- Despite assurances that the fallout from the bank failures was contained, worried depositors fled regional and smaller banks with big banks securing most of those transferred deposits. One of the proposals out of D.C. is to expand deposit insurance to all deposits for 2 yrs (or for a shorter period). Proponents argue that it would prevent deposit flight and keep big banks from getting even bigger.

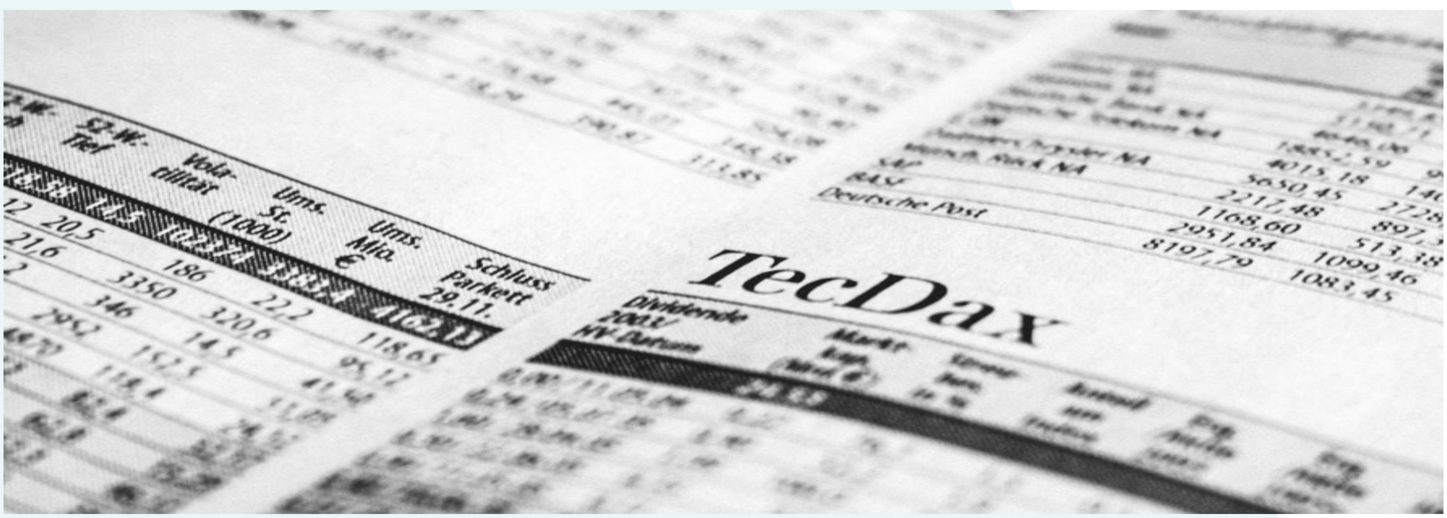
NEGATIVE DEVELOPMENTS

- The inversion between the 2-yr. and 10-yr. Treasury yields hit a record 103.5bps on 3/7, according to Refinitiv data. It later narrowed to 102.4bps. The last time the yield curve inverted by more than 100bps, or 1%, was in 1981, due to similar circumstances. Then-Fed Chair Volcker was also battling inflation. Recession followed and the unemployment rate soared.
  - Such inversions are predictive of credit crunches and recessions… They also tend to predict financial crises that halt Fed tightening. While too early to call a recession, it preempted a crisis like Silicon Valley Bank. *Note, small banks may now be exposed to depositor flight sparking a credit crunch & impacting small businesses.*

- The Leading Economic Index (LEI) for February fell 0.3%. The index recorded its 11th consecutive mo. loss, as ISM new orders, consumer expectations, the yield curve, jobless claims, and credit conditions pulled the index lower which more than offset the surge in building permits.

- At the 3/22 Fed post meeting presser, Powell assured reporters and the public that U.S. banks were well-capitalized and "sound" …later that day, Treasury Secretary Yellen told a Senate committee that "blanket" deposit insurance hadn't been considered or discussed by her department, driving stocks lower, particularly bank stocks. *Expect volatility as this discord continues.*

- Durable orders were weaker than expected in February according to the Census Bureau as orders fell 1.0%. Many economists forecasted an increase of 0.2%. Weakness in durable goods is consistent with other measures of manufacturing weakness, including falling industrial production and recent weakness in the ISM manufacturing index. *Note, manufacturing is more interest rate sensitive than services, and usually weakens before the balance of the economy*.



THE MARKETS

The SP500 closed the quarter on a high note on Friday, as evidence of cooling inflation (falling PCE) provided hopes of a softer monetary policy approach from the Fed considering recent banking sector problems.

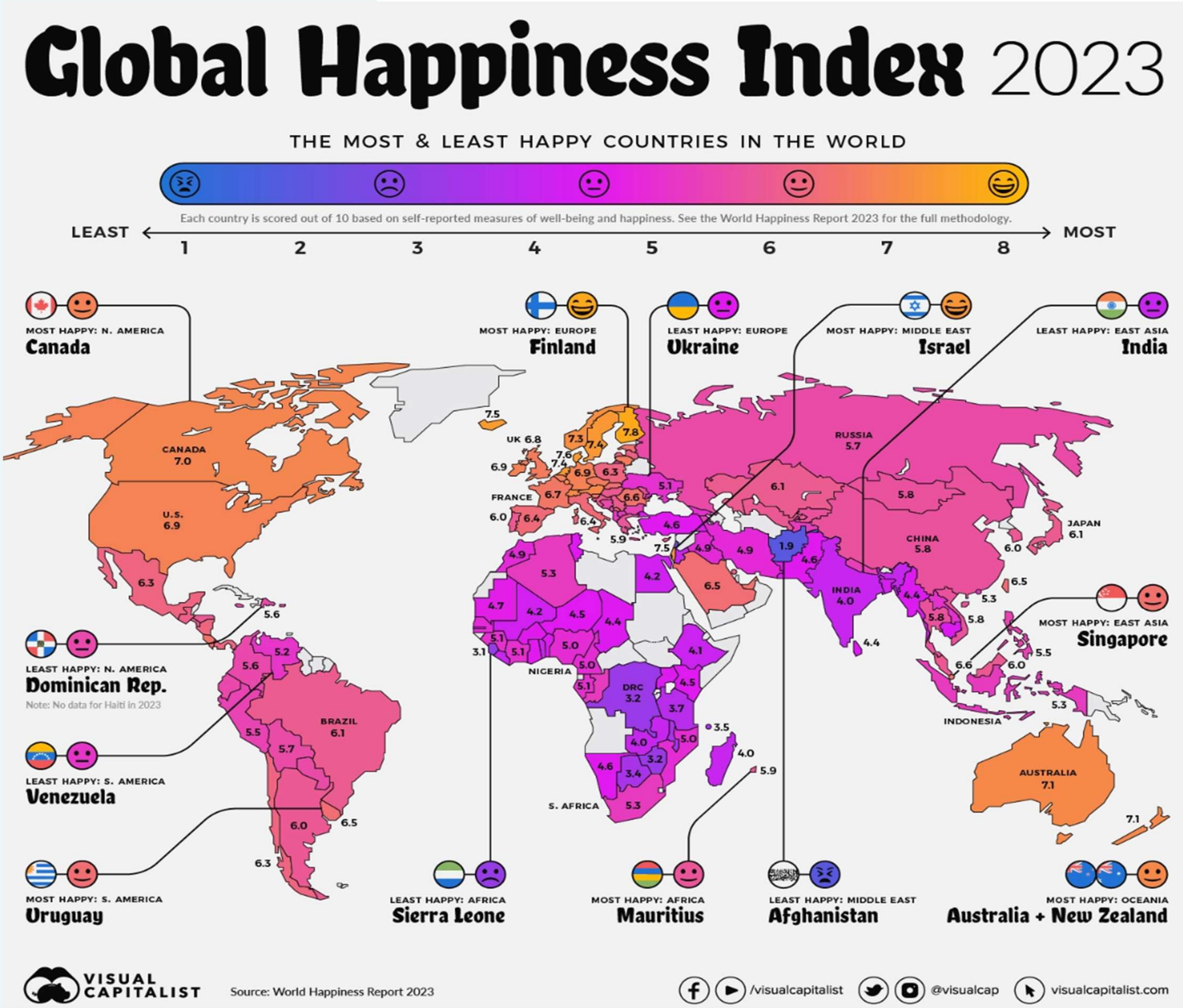
The SP500 closed the quarter up 7% while the Nasdaq posted a 16.8% gain, its first quarterly gain in five quarters, benefiting from a shift to technology and other growth stocks from financial stocks amid fears of a bank contagion. Small cap stocks, as measured by the Russell 2000, logged a 2.9% return. The cyclicals-heavy Dow was up 0.4%.

Technology and communication services were the big winners last month while energy, real estate and financials were laggards.

Across the pond, European markets were generally flat in March due primarily to weakness in the banking sectors. Asian markets followed suit last month. Both Europe and Asian markets posted nice gains in Q1.

U.S Index	Last Month (% return)	YTD (%)
S&P 500	1.5	7.0
Dow Jones	-0.4	0.4
NASDAQ Comp	4.6	16.8
Russell 2000	-6.0	2.9

Source: https://tradingeconomics.com/stocks



Source: https://www.visualcapitalist.com/worlds-happiest-countries-2023/

Graph of the Month: Global Happiness Index 2023

Ranking happiness is a particular puzzle. What are viable measures? Wealth, prosperity? Safety and health? Democratic vs Authoritarian rule? There is good reason to try and measure happiness. Governments and policymakers can have a clearer picture of what fosters happiness, and hopefully, with the right intent, can enact policies that can improve lives.

Based on the world happiness report https://worldhappiness.report/ - an annual survey of how satisfied citizens are worldwide, 2023 ranks as displayed in the graph above. The index is made up of scores assigned by self-reported answers and quality of life factors. Finland ranks as the happiest of all countries, followed by Denmark and Iceland. European countries make up the bulk of the top ten (something must be in the water over the pond), and the US ranks as the #15 happiest country in the world.

NEWS YOU CAN USE

The MLB season is upon us with opening day on 3/30. Given our Southside Chicago home bias, we will comment that the Chicago White Sox pulled off a nail-biter win in the 9th inning in their opening game. However; Sox fans are far from convinced this season will be any different from the last. They failed to give Dylan Cease the win (with a 10 strikeout, 2 hit performance through 6.1 innings), and left 20 men left on base. What was a win, felt like a loss. We are hoping for better baseball ahead.

https://www.cbssports.com/mlb/gametracker/recap/MLB_20230330_CHW@HOU/

The 2023 Final Four is set as the field of 68 has been reduced to 4. The group features a traditional name in #4 seed Connecticut, a surprise participant in #9 seed Florida Atlantic, and #5 seed San Diego State and #5 seed Miami that have never won national titles. Only one gets to cut down the nets in Houston on April 3. A lot of eyes are on UConn as they seek their fifth title of the past 24 NCAA Tournaments.

https://www.espn.com/mens-college-basketball/story/_/id/35959895/ranking-2023-men-march-madness-final-four

On 3/15 China began issuing visas in all categories for foreigners nearly 3 years after it closed its borders to foreign visitors to manage the Covid-19 virus. This move comes after China declared victory over the virus in February 2023. It is one of the last major countries to reopen its borders to tourists since the virus took over. Who's going?

https://www.usnews.com/news/world/articles/2023-03-14/china-to-reopen-to-tourists-resume-all-visas-wednesday

As always, if I can be of additional guidance, please feel free to call me at 312.485.6847.

Best regards,

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