OBSERVATIONS: *A little longer Research Corner than usual.*

- Stocks continue to digest recent events, the S&P 500 gained +1.5% on the week buoyed by technology stocks (S&P 500 Information Technology Sector) which were up +5.7%. The S&P tried and failed to get above its technically important 200-day moving average. Meanwhile, small cap and mid cap stocks (Russell 2000 Index and Russell Mid Cap Index) fell -2.6% and -2.0%, given their respective exposures to regional bank stocks–of which the S&P 500 has very little. [1]
- Too big to fail banks (i.e., Bank of America, JP Morgan, Wells Fargo, and Citigroup) are reported to have seen large deposit flows as depositors exit smaller banks. Bank of America reportedly raked in $15 billion in new deposits in a matter of days. Additionally, money market mutual funds attracted over $110 billion in inflows during the chaos, the most since April 2020.[1]
- Troubled First Republic Bank (FRC -78% since 3/8/2023), which was able (and had) to secure funding from JP Morgan amidst the SVB turmoil, had its debt cut to junk and is said to be exploring strategic options. The bank secured $30 billion in (uninsured) deposits from the largest banks in a sign to bolster confidence.[1]
- Despite the Credit Suisse news (see expectations), the European Central Bank (ECB) proceeded with a +50bps rate hike, bringing its main policy rate to 3.0%. The opening line of the bank's press release read "Inflation is projected to remain too high for too long."[2]
- US inflation was slightly higher than expected in February. Headline CPI registered 6.0% year-over-year (YoY) down from January's 6.4% YoY figure. Core CPI—which strips out volatile food and energy prices—registered 5.5% YoY in February (in January core-CPI was 5.6% YoY). Similarly, super-core-CPI—a measure of core services CPI excluding housing—eased to 6.1% YoY in February from January's 6.2%.[1]
- However, producer-prices (PPI) eased more significantly in February, with the PPI falling 0.1% in February from January. At this point, PPI inflation was 4.6% YoY in February down from January's 5.7% YoY figure.[1]
- Retail sales fell in February, down -0.4% from January, but were still 5.4% higher than February-2022. Excluding gasoline, whose prices can be very volatile, retail sales were up 6.1% over February-2022.[1]
- New housing starts came in better than expected in February, but mostly due to construction activity for multi-unit housing. New starts increased to 1.450 million units (annualized rate) in February up from January's 1.321 million annualized rate—but 93% of this increase was due to multi-family housing.[1]

EXPECTATIONS

- While all eyes are on US regional banks, Credit Suisse (CS) has been on a downhill trajectory for 15 years with the stock down -98% over that period. Over the weekend, the Swiss National Bank (Switzerland's central bank) orchestrated a take under of the 167-year-old Credit Suisse by Swiss rival UBS. The central bank's decision to wipe out certain bondholders (so called AT1 bonds) before equity holders is likely to create more questions than answers for the $250 billion AT1 bond market.[3]
- On Sunday, March 19, 2023, the Federal Reserve, in coordination with other central banks, announced improvements to swap lines among central banks to ease global funding markets.[4] Volatility is set to remain

---

[1] *Bloomberg LP*

[2] *https://www.ecb.europa.eu/press/pr/date/2023/html/ecb.mp230316~aad5249f30.en.html*

[3] *Bloomberg LP, WSJ, AT1 bonds or Additional Tier 1 bonds, are generally perpetual convertible bonds meant to act as a capital buffer to reduce taxpayer risks in the event of a bank collapse*

[4] *https://www.federalreserve.gov/newsevents/pressreleases/monetary20230319a.htm*

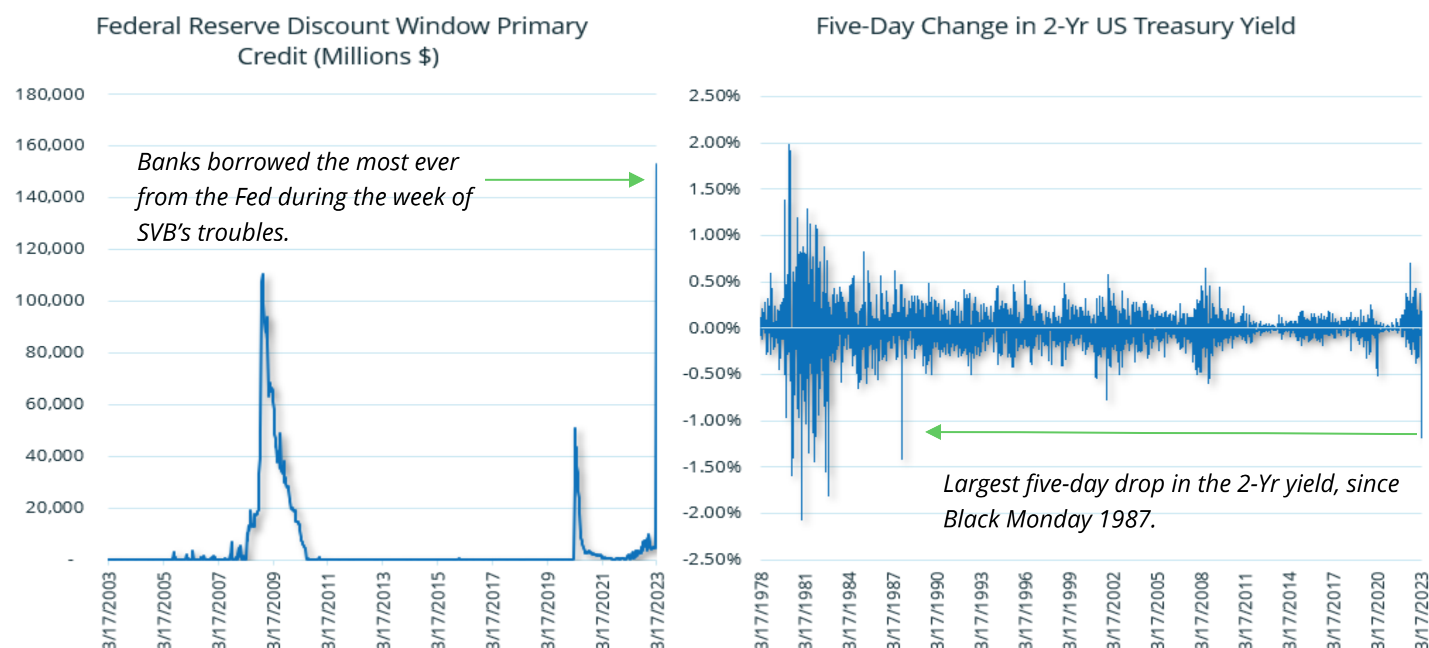
in both stock and bond markets, and we expect a series of additional measures to ultimately be taken to calm markets.
- China's central bank cut the reserve requirement ratio for banks by 25 basis-points to spur lending and signal a more pro-growth policy orientation after its key Two Sessions meetings earlier in the month, which brought in a new cohort of President Xi Jinping supporters into key economic policy posts.[1]

ONE MORE THOUGHT: *Bank crisis and inflation, is inflation set to drop?*[5]

The Fed is set to meet this week and odds for a +25bps rate hike hover near 60% (as of Monday am on March 20, 2023) with a +50bps increase off the table. Given the recent tumult across the banking sector, domestically and internationally, a pause makes sense, despite the "Fed knows something we don't" signal it may send. On the flip side, there's an argument to make that in order to maintain its credibility towards bringing down inflation the Fed should raise by +25bps, particularly given recent economic data. Either way, markets will be more interested in the signal than whether we get no change or +25bp, which in the scheme of things is like splitting hairs. Of more relevance, banking crises bring about tighter financial conditions and general deleveraging, among other things, and have generally led to disinflationary economic regimes in the aftermath. It remains to be seen what sort of disinflationary pressures this recent episode results in, but we do think it is likely to result in some downward pressure in inflation as financial conditions tighten. Between 1870 and 2022 there have been nine identified banking crises *(Global Crises Data from C. Reinhart, K. Rogoff, C. Trebesch, V. Reinhart)*. While difficult to define, the authors mark a banking crisis by "bank runs that lead to closure, merging or takeover of one or more financial institutions; or if there are no runs, the closure, merging, takeover or large-scale government assistance of an important financial institution (or group of institutions) that marks the start of a string of similar outcomes for other financial institutions." The data shows that inflation during a banking crisis was on average 2% lower than during non-crisis periods, generally observed in the first two years following a crisis. There are a lot of clear differences between all of the episodes ranging from the establishment of the FDIC, creation of the Federal Reserve system, exiting the Gold Standard, establishment of the Basel Accord (I, II, and III), and mark to market accounting principles, to name a few. The similarity across all crises is confidence, or as the case is today, a lack in confidence. It's too early to tell where this all goes for many banks, but it is logical to think about inflation as having natural headwinds in the coming year and evidence of those expectations are beginning to creep into inflation linked bond markets—5 Year breakeven rates (a market-based measure of expected inflation over the next 5-year period) have fallen from 2.8% on 8-March to 2.2% as of last Friday.

[5] *Clearstead, Bloomberg LP, Bloomberg Economics, Harvard Business School - Global Crises Data, https://www.hbs.edu/behavioral-finance-and-financial-stability/data/Pages/global.aspx*

CHARTS OF THE WEEK



Source: Clearstead, Bloomberg LP, FRB: H.4.1 Release-- Factors Affecting Reserve Balances -- Thursday, March 16, 2023 (federalreserve.gov), Treasury yield daily data as of 3/17/2023

The banking chaos in the last week drove the 2-Yr yield down by -120bps over a five-day stretch, ending March 15, 2023 — the biggest decline over any five-day period since the crash of 1987. Also of note, banks borrowed nearly $153 billion from the Fed's discount window, a record high, and eclipsing the previous high-water mark of $111 billion during the Great Financial Crisis. The Fed's new Bank Term Funding Program was tapped for $11.9 billion, though unclear what banks used the new facility.

Aneet Deshpande, CFA
Chief Strategist
Clearstead

Dan Meges
Senior Managing Director of Equity
Clearstead

Information provided in this article is general in nature, is provided for informational purposes only, and should not be construed as investment advice. These materials do not constitute an offer or recommendation to buy or sell securities. The views expressed by the author are based upon the data available at the time the article was written. Any such views are subject to change at any time based on market or other conditions. Clearstead disclaims any liability for any direct or incidental loss incurred by applying any of the information in this article. All investment decisions must be evaluated as to whether it is consistent with your investment objectives, risk tolerance, and financial situation. You should consult with an investment professional before making any investment decision. Performance data shown represents past performance. Past performance is not an indicator of future results. Current performance data may be lower or higher than the performance data presented. Performance data is represented by indices, which cannot be invested in directly.