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MARKET MINUTE

MARCH REVIEW 2023

This month's Market Minute reflects the views of our Investment Office and was composed by
Thomas Seay, Senior Managing Director, Research

OVERVIEW

March of 2023 was a volatile and difficult month for the financial markets. The month started with Fed Chair Powell's two-day testimony on Capitol Hill stating that "The latest economic data have come in stronger than expected, which suggests that the ultimate level of interest rates is likely to be higher than previously anticipated." The futures markets had pushed expectations for the Fed's terminal policy rate to nearly 5.4% by the September 2023 timeframe and on, March 8, the U.S. Treasury 10-year was yielding 3.99%[1].

Then, beginning on Thursday, March 9th, whispers of banking problems in Silicon Valley started hitting the markets. By Friday, March 10, Silicon Valley Bank (SVB) failed after a bank run, marking the second-largest bank failure in United States history and the largest since the 2007–2008 financial crisis. It was one of three U.S. banks to fail in March.[2] The ensuing banking chaos drove the U.S. Treasury 2-year 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[1]. If a domestic U.S. banking crisis was not enough, Credit Suisse, "… among the world's largest wealth managers and crucially it is one of 30 global systemically important banks, whose failure would cause ripples through the entire financial system"[3] was bailed out by UBS, the Swiss Federal Department of Finance, the Swiss National Bank, and the Swiss Financial Market Supervisory Authority. By the close of business on Friday, March 24th, the U.S. Treasury 10-year was yielding 3.38%.[1]

March's U.S. bank failures have led investors to lower their outlook for policy rate increases over the balance of the year. But, while all eyes were focused on the banking mayhem, the Federal Open Market Committee (FOMC) held a two-day meeting which resulted in a +25 bps increase in the Fed Funds rate, projections for additional policy firming, and for the rate to remain steady through year-end. Thus, the battle continues with the Fed projecting higher for longer and the markets expectations for a cut in Fed Funds by summertime. What did the financial markets do through all the chaos? Fixed income posted solid gains and a narrow group of large cap growth stocks rallied while most equities declined.

US EQUITY MARKETS As of March 31, 2023

U.S. EQUITY MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
DJIA	2.1%	0.9%	0.9%	-2.0%
S&P 500	3.7%	7.5%	7.5%	-7.8%
Russell 2000	-4.8%	2.7%	2.7%	-11.6%
Russell 1000 Growth	6.8%	14.4%	14.4%	-10.9%
Russell 1000 Value	-0.5%	1.0%	1.0%	-6.0%

U.S. large cap equities traded higher for the month, as the S&P 500 Index (+3.7%) and Russell 1000 Index (+3.2%) both gained for the month. But March's gains were heavily skewed towards large cap growth stocks. The Russell Growth Index gained +6.8%, whereas the Russell 1000 Value Index fell -0.5% and U.S. mid-caps (Russell Midcap Index) and small caps (Russell 2000 Index) both fell -1.5% and -4.8% respectively.

The losses in the Russell Midcap Index and Russell 2000 Index were fueled by their greater exposure to small and mid-sized regional and community banks, which faced a great deal of stress as nervous investors moved money out of low-interest paying savings and checking accounts and into higher yielding money market accounts or to larger—too-big-to-fail—national banks that were perceived as a safer place to park deposits. Smaller regional banks lost about -$165 billion in deposits between end of February and March 22, as depositors reacted to the spat of bank failures.

INTERNATIONAL EQUITY As of March 31, 2023

INTERNATIONAL EQUITY MARKETS				
Index	1 Month	Quater-To-Date	Year-To-Date	1 Year
MSCI ACWI ex USA	2.4%	6.9%	6.9%	-5.1%
MSCI EAFE	2.5%	8.5%	8.5%	-1.4%
MSCI Emerging Markets	3.0%	4.0%	4.0%	-10.7%
MSCI EAFE Small Cap	-0.2%	4.9%	4.9%	-9.8%

International equities also traded higher in March but lagged U.S. equities. The MSCI EAFE Index gained 2.5% in March while the MSCI Emerging Markets Index gained 3.0%. Both indices were aided by the modest decline of the U.S. dollar in March, which helped boost returns for U.S.-based investors. China was one of the best performing non-U.S. market in March—the MSCI China Index gained 4.5% –as the post-Covid reopening of the Chinese economy gains momentum and recent policy announcement from Chinese officials have buoyed consumer confidence and spending in the domestic economy.[4]

FIXED INCOME As of March 31, 2023

FIXED INCOME MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
BarCap US Aggregate	2.5%	3.0%	3.0%	-4.8%
BarCap Global Aggregate	3.2%	3.0%	3.0%	-8.1%
BarCap US High Yield	1.1%	3.6%	3.6%	-3.3%
JPM Emerging Market Bond	1.4%	2.2%	2.2%	-5.9%
BarCap Muni	2.2%	2.8%	2.8%	0.3%

The main driver of fixed income market performance was the significant decline in rates as U.S. Treasury 2-year yields declined by 79 bps (4.82% vs. 4.03%) while Treasury 10-year yields declined by 45 bps (3.92% to 3.47%). Although the declines were significant, they essentially reversed the rise in rates witnessed in February and the 10-year remains in a trading range that has prevailed since last September.

As might be expected during a banking crisis, investors rushed to the safe haven status of U.S. Treasury securities (Bloomberg U.S. Treasury index returned 2.89%) versus high yield bonds (Bloomberg High Yield index returned 1.07%). But March's winners were simply February's laggards and, for the entire first quarter of 2023, U.S. domestic sector returns all delivered solid returns: Bloomberg Treasury 3.01%, Bloomberg Municipal 2.78%, Bloomberg Investment Grade Corporate 3.50% and Bloomberg High Yield 3.57%.

CONCLUSION & OUTLOOK

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 a deterioration in credit availability, demand, and quality. The silver lining here is that weaker demand and tighter credit conditions could help accelerate ongoing disinflation and allow the Fed to end the tightening cycle sooner than they otherwise might have at their first meeting in 2023 seven weeks ago. But we should not forget that, amidst the banking crisis, the Fed raised the Fed Funds rate and stated, "… inflation remains too high, and the labor market continues to be very tight." Jerome Powell's Fed remains dedicated to bringing inflation down and their blunt tool at hand is to continue driving interest rates higher. As such, should the banking panic prove short-lived, interest rates may rise again as economic data remains strong. At the risk of sounding like a broken record, until the time arrives where we have conviction that the Fed has reached its terminal rate, we are inclined to maintain portfolios that drive returns from income characteristics (i.e., dividends and enhanced yield strategies) and are not dependent on capital appreciation to achieve clients' financial goals.

SOURCES

1 Bloomberg, LP
2 The New York Times, March 10, 2023
3 Reuters, March 18, 2023

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