Things That Matter

Cerity Partners Investment Committee

March 27, 2023

Confidential & Proprietary

Equity markets show resiliency despite the global banking turmoil and as central banks attempt to manage both inflation and financial stability.

- Equity markets are showing impressive resiliency considering the brewing bank crisis, as the resulting bond market rally has helped the more growth-oriented sectors of the stock market. The Federal Reserve (Fed) and other central banks continue to attempt to separately address price stability and financial stability, but the anticipation of the end of the monetary tightening cycle is an additional support while we await first quarter earnings and further signs of the state of the economy in light of the sharp increases in interest rates already implemented into the system.

The Fed Stays the Course

- After the Federal Open Market Committee (FOMC) meeting last week, the Fed in a unanimous decision increased the federal funds rate by 25 basis points (bps) to 4.75%–5.00%. While there was growing belief prior to the meeting that the Fed might pause rate hikes given the recent banking turmoil, this move was largely in line with expectations.

- The accompanying statement was deemed incrementally dovish as the Fed viewed ongoing rate increases as "possibly being appropriate"—which market participants took as a more definitive sign the Fed may be nearing an end to rate hikes. The Summary of Economic Projections showed the median federal funds rate forecast peaking at 5.1%, no change from December and suggestive of only one more 25 bps rate hike before the rate hike portion of the tightening policy ends. There was no change in the balance sheet reduction plans and the statement went on to claim that the "U.S. bank system is sound and resilient."

- In his press conference following the meeting, Fed Chair Jerome Powell said inflation continues to run high and there is a long way to go to get to the 2.0% target and that rate cuts were not expected this year. He delivered these comments despite the bond market's strong signal the Fed will be cutting rates as early as this summer. Powell said the FOMC considered a pause, but a rate hike was necessary given the recent strong data, particularly in the labor market. He acknowledged that the banking crisis will tighten financial conditions. Market participants are struggling to assess the impact of tightening conditions in terms of federal funds rate increases with the current consensus at 25–50 bps. Powell said it is too early to say if an economic soft landing is still possible.

Stock Markets Plummet Following Treasury Comments

- Stock markets were generally positive after the release of the Fed's statement and during most of the press conference but then turned down sharply in the last hour of trading on Wednesday, as U.S. Treasury Secretary Janet Yellen in Senate testimony that ran concurrent to the press conference said the Treasury was not considering a broad increase in deposit insurance in the banking industry. The reality is that such a broad increase would likely require congressional approval and markets grew more comfortable by the end of the week with the implicit messaging and actual regulatory response to recent bank failures that the government will step up when needed in an emergency situation.

Balancing Inflation and Financial Stability Amid Banking Turmoil

- As the European Central Bank did the prior week, the Bank of England (BOE) and the Swiss National Bank (SNB) are also attempting to isolate inflation-fighting monetary policy from policies used to ensure financial stability. The BOE increased its key rate 25 bps while the SNB increased its key rate by 50 bps as they attempt to catch up from their slow start to the tightening process. Both central banks noted the banking industry turmoil and increase in funding costs, which could have a negative impact on the respective economies and help bring down inflation. After the merger of Credit Suisse into UBS was announced last weekend, Deutsche Bank got into the market's crosshairs by the end of the week with a big decline in its stock price and a sharp increase in credit default swap spreads. This news heightened concern going into the weekend that commercial banks continue to be subject to massive withdrawals as money market funds generally have better rates and ostensibly greater credit security.

State of the Economy Remains Shaky but Shows Some Promise

- Housing continues to show signs of bottoming as February existing home sales were up 14.5% to 4.58 million, a comfortable beat of the estimated 4.20 million. It was notable that this growth was achieved despite a roughly 70 bps increase in mortgage rates during the month. Inventories of existing homes are still rather tight at 2.6 months' available supply, but median prices did fall slightly on the month, which broke an eleven-year streak of monthly price increases. February new home sales were not nearly as strong, but still rose 1.1% from a downwardly revised January figure. New home inventory is much more ample at 8.2 months so we expect a slowdown in price increases in the coming months, which should lead to an eventual decline in the published shelter price inflation statistics.

State of the Economy Remains Shaky but Shows Some Promise (continued)

- Some mixed signals are coming out of the capital spending data as February durable goods orders declined 1.0%, a directional miss of the +1.1% estimate with an accompanying downward revision to January's reading. Orders have now declined for three of the past four months, although "core" orders, which exclude lumpy defense industry and aircraft orders, were up 0.2%, still a miss of the +0.5% estimate. Considering the inflationary environment, real orders have declined even more in early 2023.

- A potential offset to this somewhat sobering statistic was the March S&P Global Flash Purchasing Managers' Index surveys, which showed the manufacturing survey increasing to 49.3 from 47.3, a beat of the 47.2 estimate. The services flash reading was even better, climbing comfortably into expansion territory at 53.8 from 50.6. Like manufacturing, the services survey was expected to decline month over month. It was the third consecutive monthly gain for both surveys.

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