

Monday, March 13, 2023

Good morning:

One year ago this week, the Fed began an aggressive monetary tightening campaign to normalize interest rates after several years of near 0% rates in an effort to quell rising inflation. Many now realize that the Fed's apprehension to start raising rates sooner contributed significantly to inflation's eventual surge. As a result, the Fed hiked rates eight times, bringing the Fed Funds rate from 0.25% to 4.75% as of today with more hikes expected. This magnitude of interest rate increases over such a relatively short period of time has never been done before but was bound to result in some unintended consequences.

Last week brought some of these issues into the spotlight as several regional banks announced they needed to raise capital to shore up their balance sheets to meet regulatory requirements. Despite one of these bank's CEO asking investors and customers to "stay calm," many depositors started immediately pulling their deposits, accelerating a run on these banks. With FDIC insurance limits at \$250,000, scores of businesses that held millions in uninsured balances in these banks were panicked. By Friday, the FDIC declared the banks' failures and stepped in to take over operations and guarantee insured deposits.



The general equity market selloff also wasn't helped by Friday's monthly payroll reports that showed 311,000 new jobs were created versus an expectation of 223,000, although the rate of wage growth was clearly slowing. For the week, the S&P 500, Dow, and NASDAQ were each down about 4½%, while the small cap Russell 2000 Index lost 8.03%.



Source: FRED

With so many companies, particularly in the emerging technology sector in Silicon Valley, holding the bulk of their liquid assets in these banks, the U.S. Treasury, the Fed, along with the FDIC came together over the weekend to create a backstop for ALL of these failed banks' deposits. While this may prevent further negative repercussions for these banks' business customers, it has not extinguished the broader level of concern for other such banks, particularly the regionals. Many of the issues that led to these events were unique to a very small number of particular banks that concentrated their customer and deposit base in one sector like technology or crypto firms. With this not being the case with most other banks, particularly the larger ones, today's continued selloff across all banks seems indiscriminate and clearly fueled by uncertainty and fear.



Despite the steep declines across the financial sector, all major averages are up about 1% this morning as capital rotates into other areas for either safety or proven growth. Large Cap Tech, Healthcare, and Biotechnology companies are leading this move higher today. Short-term bond yields are also dropping as funds flow into the safety of Treasuries. However, we have obviously entered a period of heightened volatility due to these many new uncertainties. Assuming that this banking credit crunch can be contained, the market's focus will quickly shift to the Fed next Wednesday. If things have stabilized in the financial sector, we expect another 0.25% rate hike. However, if we see a widening bank contagion by then, it may result in a pause by the Fed. Either way, many will try to carefully interpret the Fed's actions and comments to gauge their level of concern about any broader systemic problems in our country's financial sector.



Each time the market experiences a financial or banking crisis, the knee-jerk reaction to sell everything is nearly always incorrect as it stems from fear or panic. Once cooler heads prevail, those who sold often wish they were more patient. Our nation recognizes that a strong and stable banking system is critically fundamental to a healthy economy. Events like these weed out, in some cases, those institutions that took too much risk, and often lead to new regulations to further strengthen all banks in the future.

We will remain focused on our clients' longer-term objectives as we closely monitor all developments impacting the markets each day.

Have a great week!

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The Dow Jones Industrial Average (DJIA), commonly known as "The Dow" is an index representing 30 stocks of companies maintained and reviewed by the editors of the Wall Street Journal.

S&P 500 Index is an unmanaged, market value-weighted index of 500 stocks generally representative of the broad stock market. An investment cannot be made directly in a market index.

The NASDAQ Composite Index is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represent approximately 8% of the total market capitalization of the Russell 3000 Index.

Investing in small cap stocks generally involves greater risks, and therefore, may not be appropriate for every investor.

The companies engaged in the communications and technology industries are subject to fierce competition and their products and services may be subject to rapid obsolescence.

Market return and statistical data obtained from: [https://am.jpmorgan.com/blob-gim/1383452890099/83456/weekly\\_market\\_recap.pdf?segment=AMERICAS\\_US\\_ADV&locale=en\\_US](https://am.jpmorgan.com/blob-gim/1383452890099/83456/weekly_market_recap.pdf?segment=AMERICAS_US_ADV&locale=en_US)

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