

Mounting stress in credit signaling Fed change



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Stress in credit markets signaling Fed change at hand

- There are after-shocks from the collapse of SVB Financial (aka Silicon Valley Bank). The public remains rattled that a bank like SVB could collapse so quickly.
- And SVB has exposed the operational challenges (deposits vs investments) for banks in a world where central banks have raised rates sharply. And equity and bondholders are wary given FDIC/Fed actions wiped out stakeholders. Worsening this is several rating agencies downgraded regional banks, moving many to below investment grade, which raises these banks cost of funding.
- Bond volatility has surged to highest level since 2009 (ICE MOVE index) and is amplifying stresses across credit and rates markets.
- This has driven an abrupt shift in Fed rate path expectations. Only a week ago, the consensus was Fed path was “higher for longer” and Powell on 3/7 delivered a hawkish message underscoring that point. And Fed futures saw ~5 hikes over next 5 meetings.
- Markets now see ~100bp of cuts post-May and barely 1 hike in total between March/May meetings. The “higher for longer” is dead. That is a huge change in the past week.
- This has created challenges for equity markets in the short-term. Our Head of Technical Strategy, Mark Newton, believes equity markets are bottoming near-term but the next few days are critical to whether this view holds.
- Perhaps the liquidity actions taken by Credit Suisse calm markets, but if not, we expect communication from the Fed. But the next 5 trading days will be key because in this timeframe, we get more Feb inflation/economic data and March FOMC rate decisions.



ECONOMIC CALENDAR: Key Upcoming Events

CALENDAR: Key incoming data starting March 10

There is lot of incoming economic data this week (durable goods, housing, unit labor costs and ISM) but for the key inflation-related data, there is a bit of a dead spot until early March. As shown below, this really starts March 10th:

- ~~3/7 10 am ET Powell testifies Senate~~ **Hawish**
- ~~3/8 10am ET Powell testifies House~~ Neutral
- ~~3/8 10am ET JOLTS Job Openings (Jan)~~ **Semi-strong**
- ~~3/8 2pm ET Fed releases Beige Book~~ **Soft**
- ~~3/10 8:30am ET Feb employment report~~ **Soft**
- ~~3/13 Feb NY Fed survey inflation exp.~~ **Soft**
- ~~3/14 6am ET NFIB Feb small biz survey~~ **Soft**
- ~~3/14 8:30am ET CPI Feb~~ **Tame**
- ~~3/15 8:30am ET PPI Feb~~ **Tame**
- 3/17 10am ET U. Mich. March prelim 1-yr inflation
- 3/22 2pm ET March FOMC rate decision
- 3/31 8:30am ET PCE Feb



Market prone to panic... equity resilience sign “inflation broke”

- Just an anecdotal observation, but the world just seems more prone to panic since the pandemic.
- While the collapse of SVB has triggered logical concerns of contagion, too many investors are reflexively overlaying 2008 GFC. It is the most recent financial crisis and the freshest for many.
- But as inflation surged in 2021-2022, investors were quick to label inflation as an era with risk of inflation being sticky for years. But that analog has not held. Even looking at lagged CPI data, inflation has softened in February compared to January evidenced by the Feb jobs report, Feb CPI and PPI. So the trend remains inflation is softening.
- And the SVB collapse and the associated ripple effects across the start-up community should deliver a softening of the labor market. Moreover, with financial stability more at the top of mind for many, how many employees will now seek raises? Similarly, the credit shock and higher cost of borrowing means credit growth on the margin will slow.
- These are reasons we expect inflation to fall in future months and is also evidenced by Fed rate expectations and the plunge in rates.
- The question is, have rates fallen due to “inflation breaking” or because “economy breaking.”
- For reasons noted above, we think this is more “inflation breaking” and thus, Fed can take its foot off the gas. Moreover, the relative resilience of stocks (relatively milder drawdown and the lower amplitude rise in VIX) also suggest to us this drop is inflation.
- Look at Technology, which is asserting its leadership. This would not rise if recession risks are rising.
- And just because there is financial carnage, including many funds suffering losses, doesn’t mean this episode has to turn into a financial crisis and recession. But action by the Fed is key.



PUBLIC: Public trust ...despite BTFP

MONEY

Banking and Financial Services

Add Topic +

Is my money safe in the bank right now? More depositors are wondering after SVB's collapse

Bailey Schulz, Elisabeth Buchwald and Paul Davidson USA TODAY

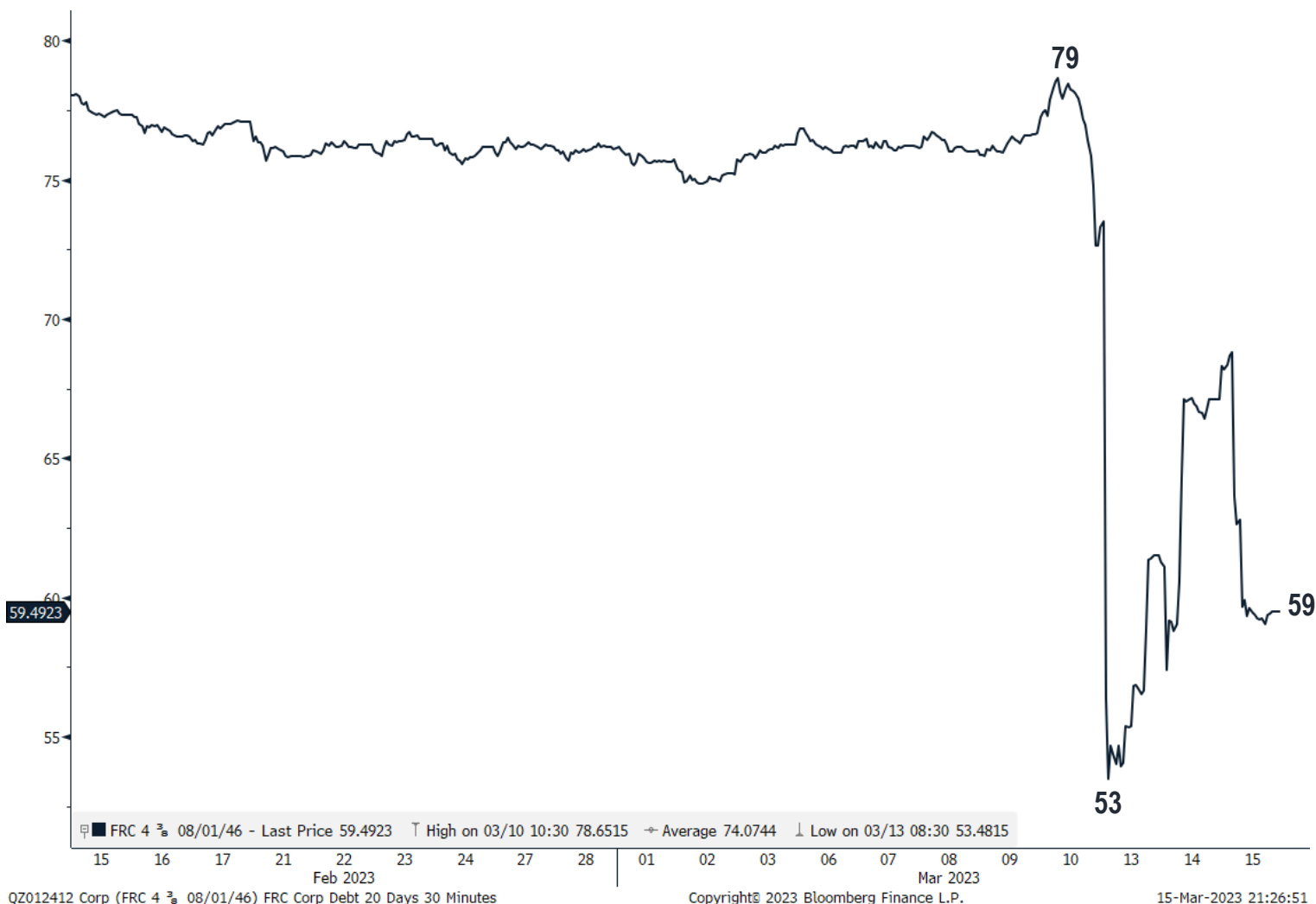
Published 3:58 p.m. ET March 15, 2023





BANK TRUST: Regional bank long-term paper trading distressed

First Republic – Long term debt price (2046 due) as % par
Past Month



Source: Fundstrat, Bloomberg



RATING AGENCIES: banks lose investment grade... how to survive?

1) Fitch Downgrades First Republic to 'BB'; Places Ratings on Negative Watch	FII	11:12
2) *Fitch Downgrades First Republic to 'BB'; Places Ratings on Negative Watch	DJ	11:12
3) First Republic, Goldman Sachs stocks lead renewed selloff in banks, while Oatly and Smartsheet shares gain	DJ	11:01
4) First Republic Bank Stock Resumes Selloff -- WSJ	DJ	11:00
5) First Republic Volume, Options Rise; Block Trades: 15 Signals	BN	10:12
6) First Republic Bank: Buy When There Is Blood In The Street	SKA	10:12
7) First Republic Options Rise; Block Trades: 14 Signals	BN	10:00
8) Bank Crisis: U.S. Banks Head For More Losses, Rattled By European Weakness -- IBD	DJ	09:59
9) First Republic Pulls US Banks Down as Credit Suisse Plunges (2)	BFW	09:59
10) *First Republic Bank (FRC) Resumed Trading	DJ	09:52
11) *TRADING RESUMED: FRC (NYSE)	BHT	09:52
12) Cascade of Bank Halts Raises Fresh Worry	BFW	09:49
13) *First Republic Bank (FRC) Paused due to volatility	DJ	09:47
14) *CIRCUIT BREAKER: FRC (NYSE)-VOLATILITY TRADING PAUSE	BHT	09:47
15) FRC: First Republic falls -21.3%	FLY	09:47
16) S&P 500 Banks Industry Group GICS Index Falls 3.8%	BN	09:45
17) First Republic Bank bleeds red on rating cut to Junk at S&P	SKA	09:43
18) FRC: First Republic trading resumes	FLY	09:43
19) *FIRST REPUBLIC HALTED FOR VOLATILITY AFTER PARING DROP TO 15%	BFW	09:40
20) FRC: First Republic trading halted, volatility trading pause	FLY	09:38
21) X-S&PGR Lowers First Republic Bank To 'BB+'; Puts On Watch Neg	SPC	09:34
22) First Republic 1.07M Share Block Trades at \$31.87	BN	09:32
23) *FIRST REPUBLIC BANK SINKS 26% AT OPEN AFTER S&P CUTS TO JUNK	BFW	09:30
24) First Republic Bank stock tumbles 27.1% premarket toward fresh 12-year low	DJ	09:29
25) Regional Banks Under Pressure Following Rout In European Lenders -- Market Talk	DJ	09:24
26) S&P Says First Republic Bank Downgraded To 'BB+' From 'A-' On Funding Profile Risk; Ratings On CreditWatch Negative; Believe	BZG	09:24
27) First Republic Cut to Junk by S&P on Outflow Risk (2)	BFW	09:24
28) *FIRST REPUBLIC SHARES EXTEND PREMARKET DECLINE TO 15%	BFW	09:19
29) *S&P: FIRST REPUBLIC BANK RISK OF DEPOSIT OUTFLOWS IS ELEVATED	BN	09:18
30) *FIRST REPUBLIC BANK CUT TO JUNK BY S&P; ON WATCH NEG	BN	09:18
31) A Look At First Republic Bank's Chart Following SVB Financial Collapse	BZG	09:18
32) *S&P: First Republic Bank CreditWatch Negative Reflects Lack of Visibility on Level and Pace of Deposit Volatility, Potential fo	DJ	09:17

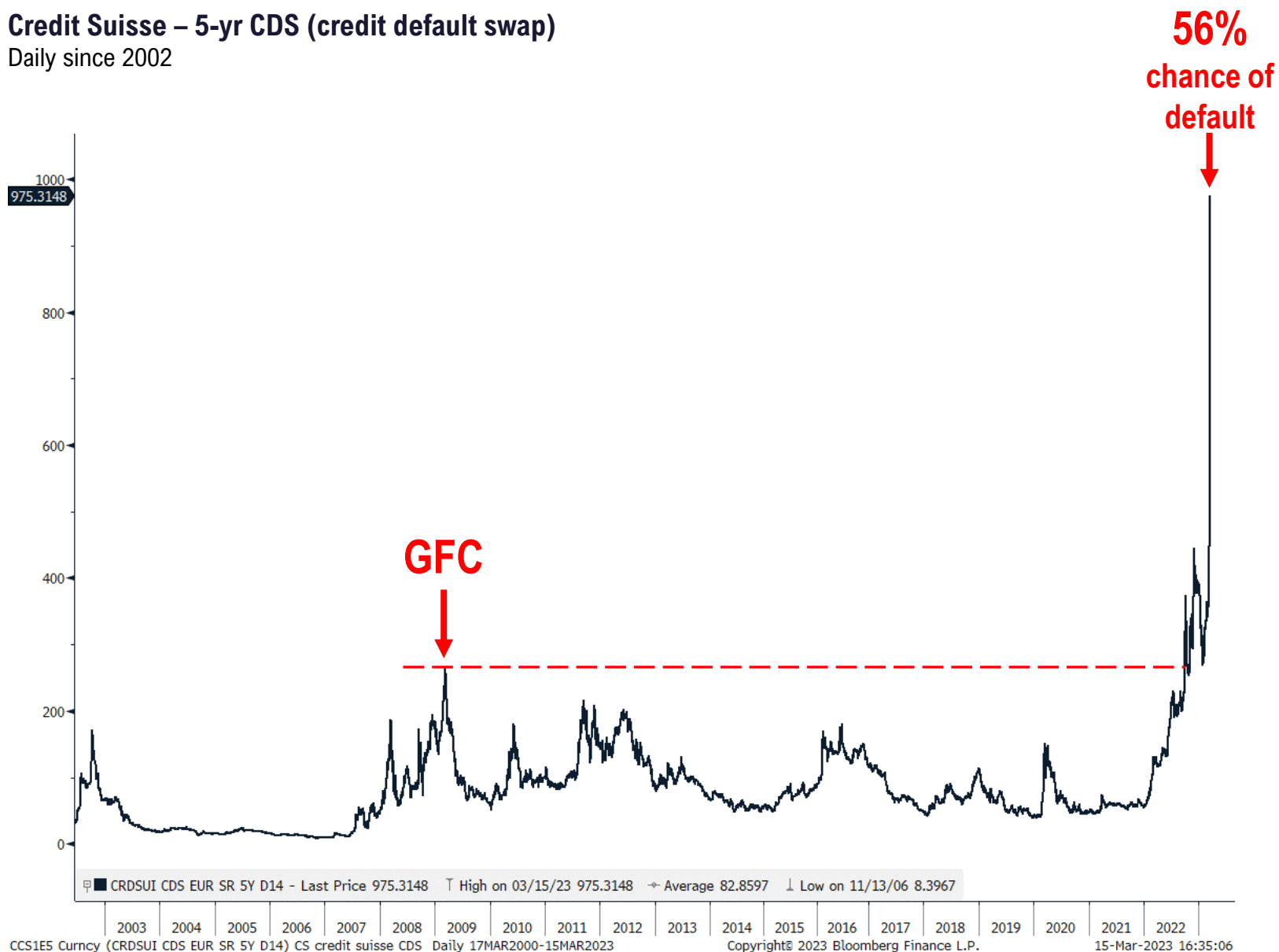
Source: Fundstrat, Bloomberg



DEFAULT RISK: G-SIB banks like CS CDS implies 56% chance of default

Credit Suisse – 5-yr CDS (credit default swap)

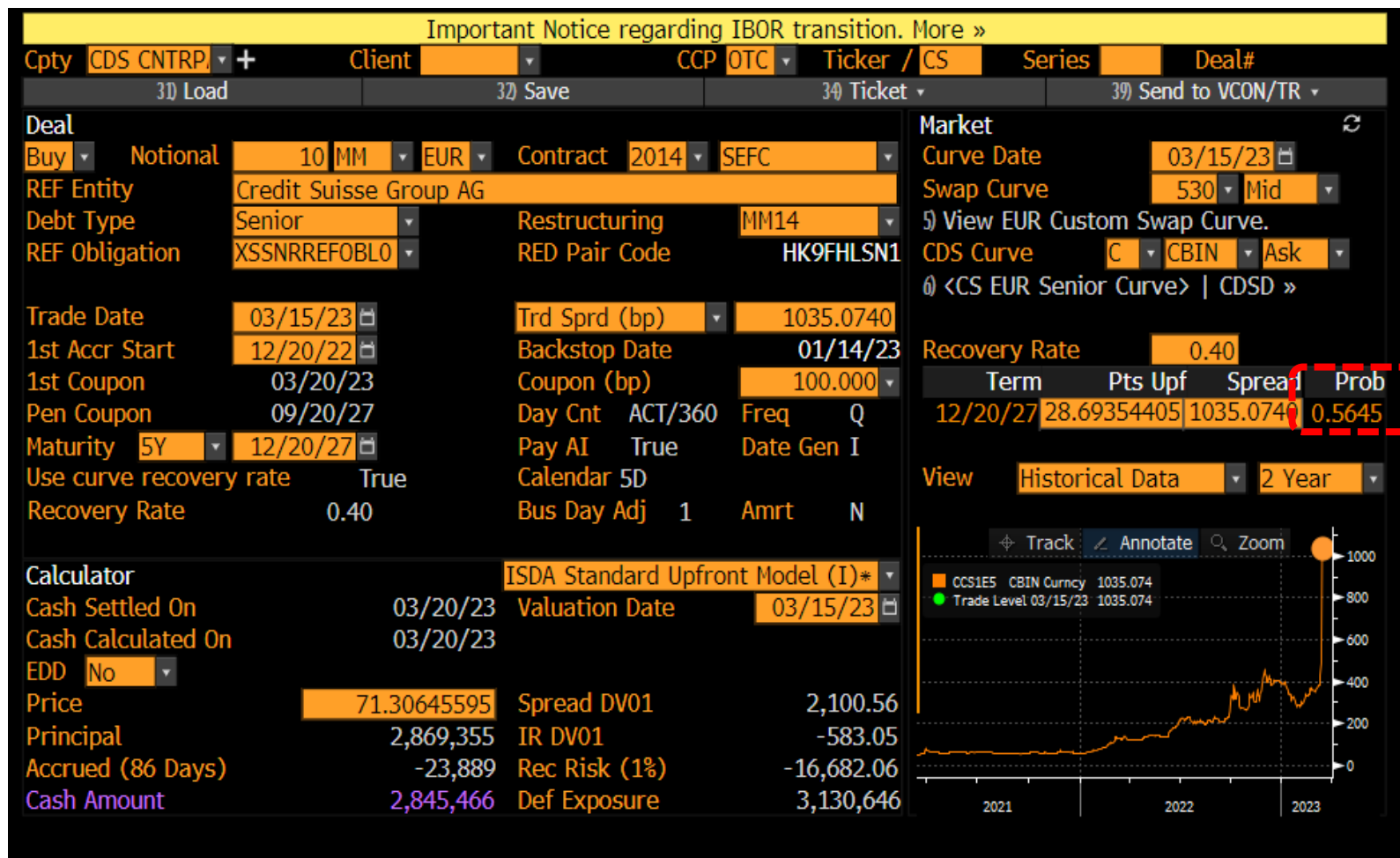
Daily since 2002



Source: Fundstrat, Bloomberg



CREDIT SUISSE CDS: Swap pricing implies 56% chance of default

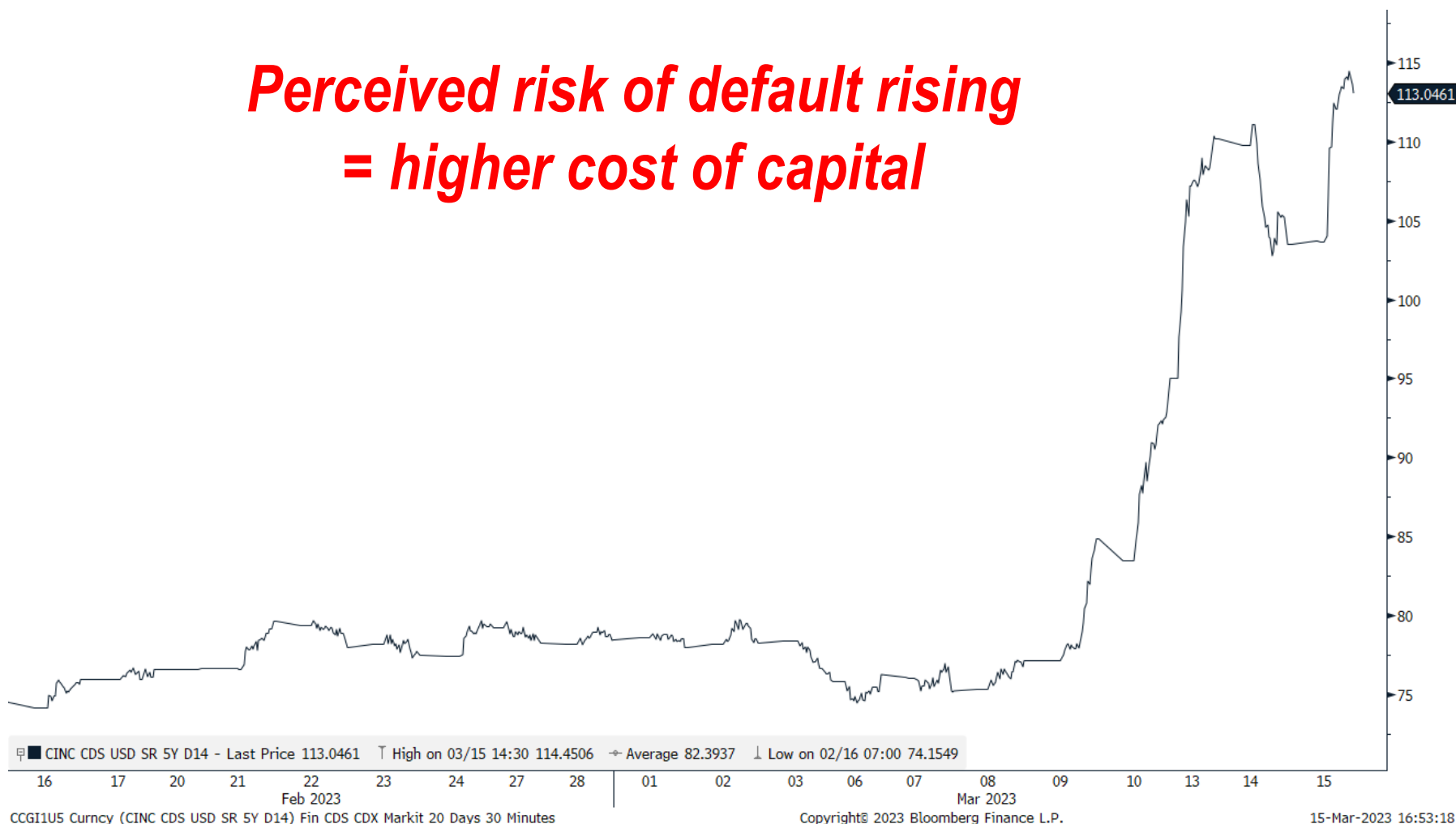


Source: Fundstrat, Bloomberg

CITI: Elevated risk for SIB (systematically important)

Figure: Citigroup 5-yr CDS
Past month

***Perceived risk of default rising
= higher cost of capital***



Source: Fundstrat, Bloomberg



MOVE INDEX: Bond volatility highest since 2009

Figure: MOVE Index surges to highest levels since 2009
Since 2001



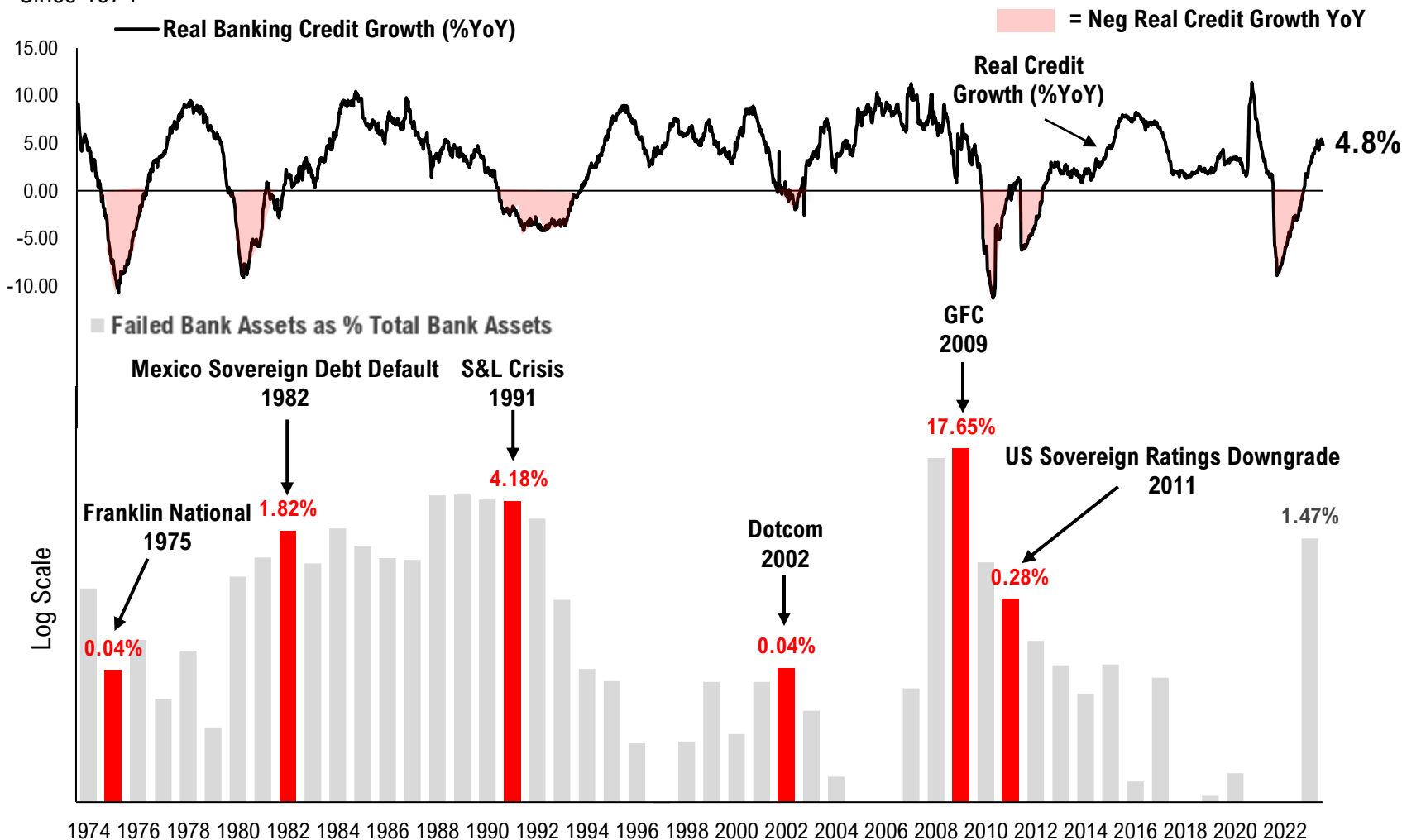
Source: Fundstrat, Bloomberg



CREDIT: History of Real Credit Growth and Bank Failures

Real Credit Growth (%YoY) and Failed Bank Assets as a % of Total Bank Assets

Since 1974



Source: Fundstrat, Bloomberg, Fed H8, FDIC



YIELDS: Interest rates 2Y and 10Y tank

Yields 10Y and 2Y

Daily



USGG2YR Index (US Generic Govt 2 Yr) Yields 10yr + 2yr Daily 15MAR2022-15MAR2023

Copyright© 2023 Bloomberg Finance L.P.

15-Mar-2023 21:47:33

Source: Fundstrat, Bloomberg



RATE PATH: No “higher for longer” now “~80bp of rate cuts by YE”

Fed Funds by Dec 2023
Daily



Source: Fundstrat, Bloomberg



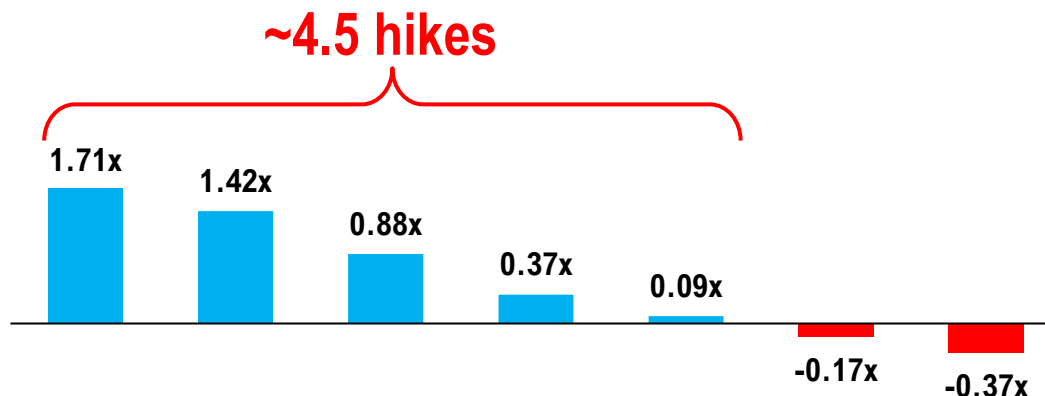
RATE PATH: In a mere week, +4.5 hikes to ~4 cuts... 8 hike swing

Estimated # of Hikes/Cuts for Each FOMC Meeting

Each hike = 25bp

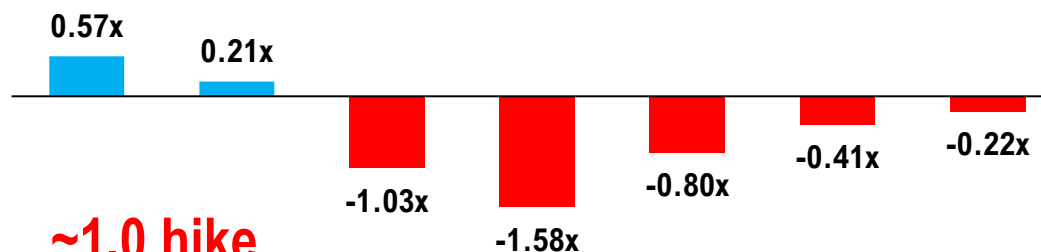
3/8/23

Powell Testimony to Congress



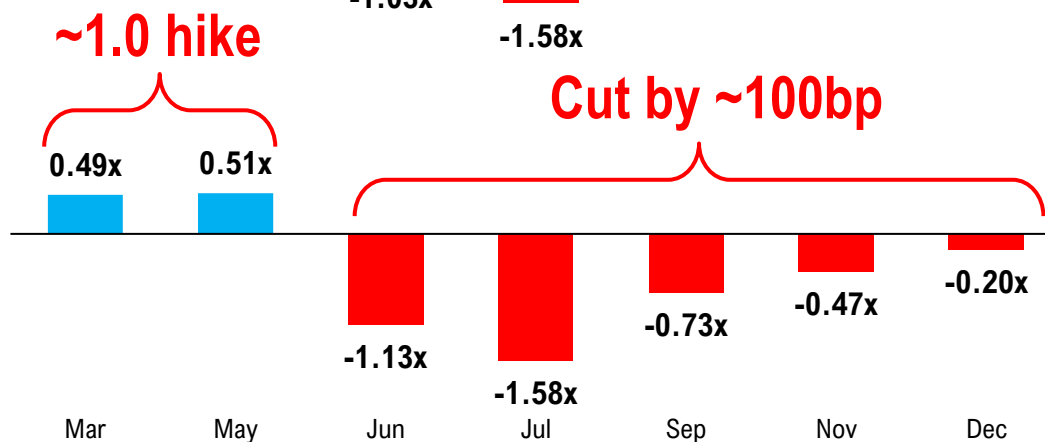
3/13/23

Post BTFP



3/15/23

Wed close



Source: Fundstrat, Bloomberg

* Est. # hikes/cuts via Bloomberg WIRP model based on Fed Funds futures price.



FED: Dual mandate... but there is an overarching mandate

Board of Governors of the Federal Reserve System

The Federal Reserve, the central bank of the United States, provides the nation with a safe, flexible, and stable monetary and financial system.

Monetary Policy: What Are Its Goals? How Does It Work?

What are the goals of monetary policy?

The Federal Reserve Act mandates that the Federal Reserve conduct monetary policy "so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates."¹ Even though the act lists three distinct goals of monetary policy, the Fed's mandate for monetary policy is commonly known as the **dual mandate**. The reason is that an economy in which people who want to work either have a job or are likely to find one fairly quickly and in which the price level (meaning a broad measure of the price of goods and services purchased by consumers) is stable creates the conditions needed for interest rates to settle at moderate levels.²

Source: Fundstrat, Federal Reserve



FED: Federal Reserve Act created Fed for “financial stability”

Board of Governors of the Federal Reserve System

The Federal Reserve, the central bank of the United States, provides the nation with a safe, flexible, and stable monetary and financial system.

Federal Reserve Act

The Federal Reserve Act of 1913 established the Federal Reserve System as the central bank of the United States to provide the nation with a safer, more flexible, and more stable monetary and financial system. The law sets out the purposes, structure, and functions of the System as well as outlines aspects of its operations and accountability. Congress has the power to amend the Federal Reserve Act, which it has done several times over the years. The complete act, as amended, is provided here by section.

Source: Fundstrat, Federal Reserve

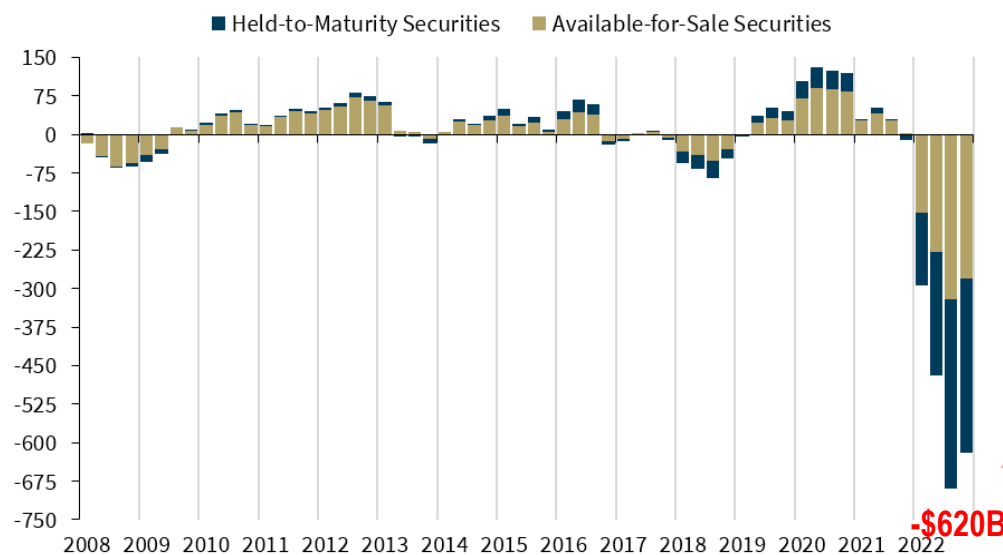
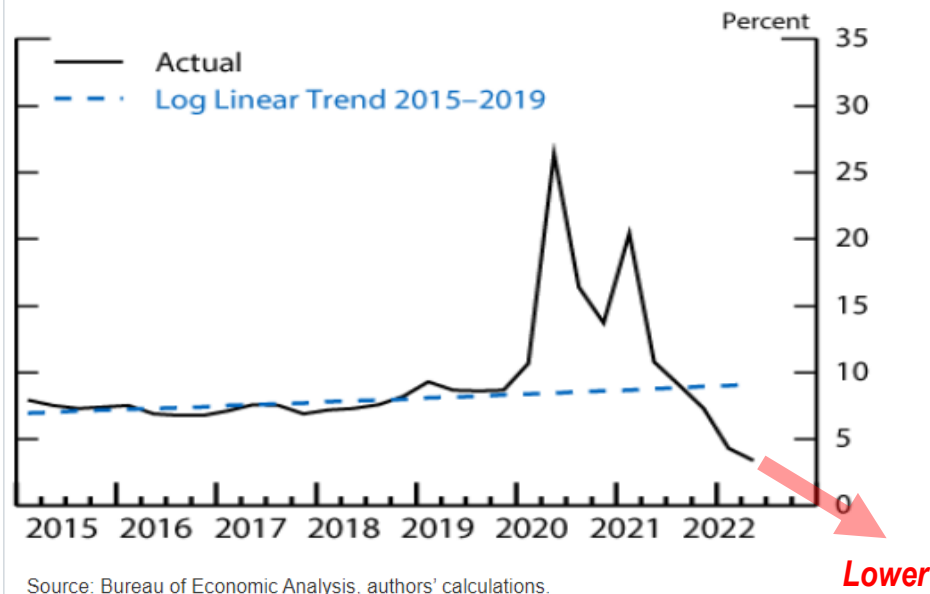


Issues behind SIVB get worse if Fed continues to hike

Savings will dwindle as employment softens



Figure 1. Personal Saving Rate



Bank losses on securities worsen as short-term rates rise

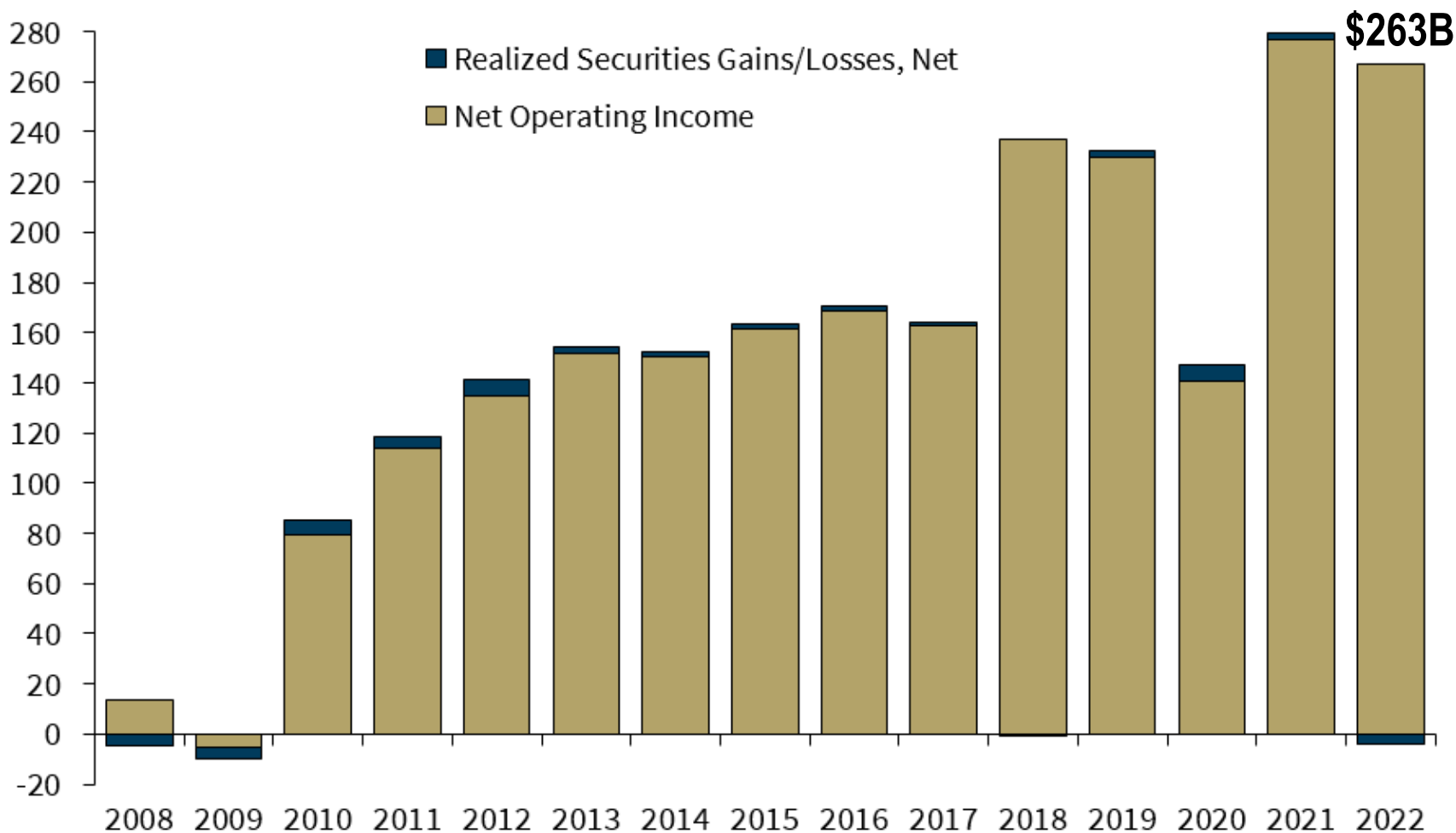
More losses



Banks are plenty profitable... \$260 billion in profits in 2022

Bank profit vs. net realized securities gains/losses

Since 2008



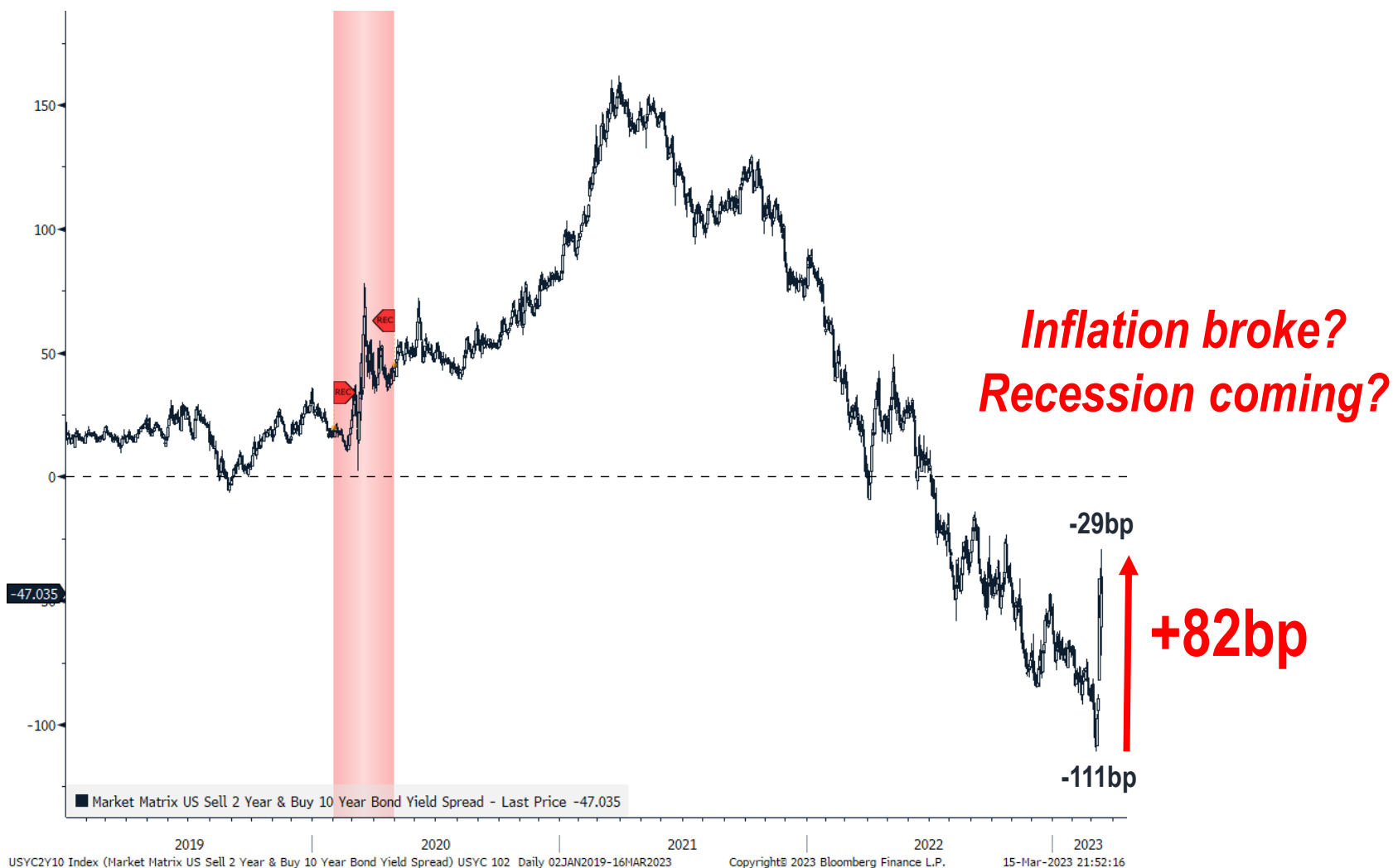
Source: FDIC Quarterly Banking Report Dec 31, 2022



BROKEN: Yield curve is “un-inverting”

YIELD CURVE: 10Y yields less 2Y yields

Daily



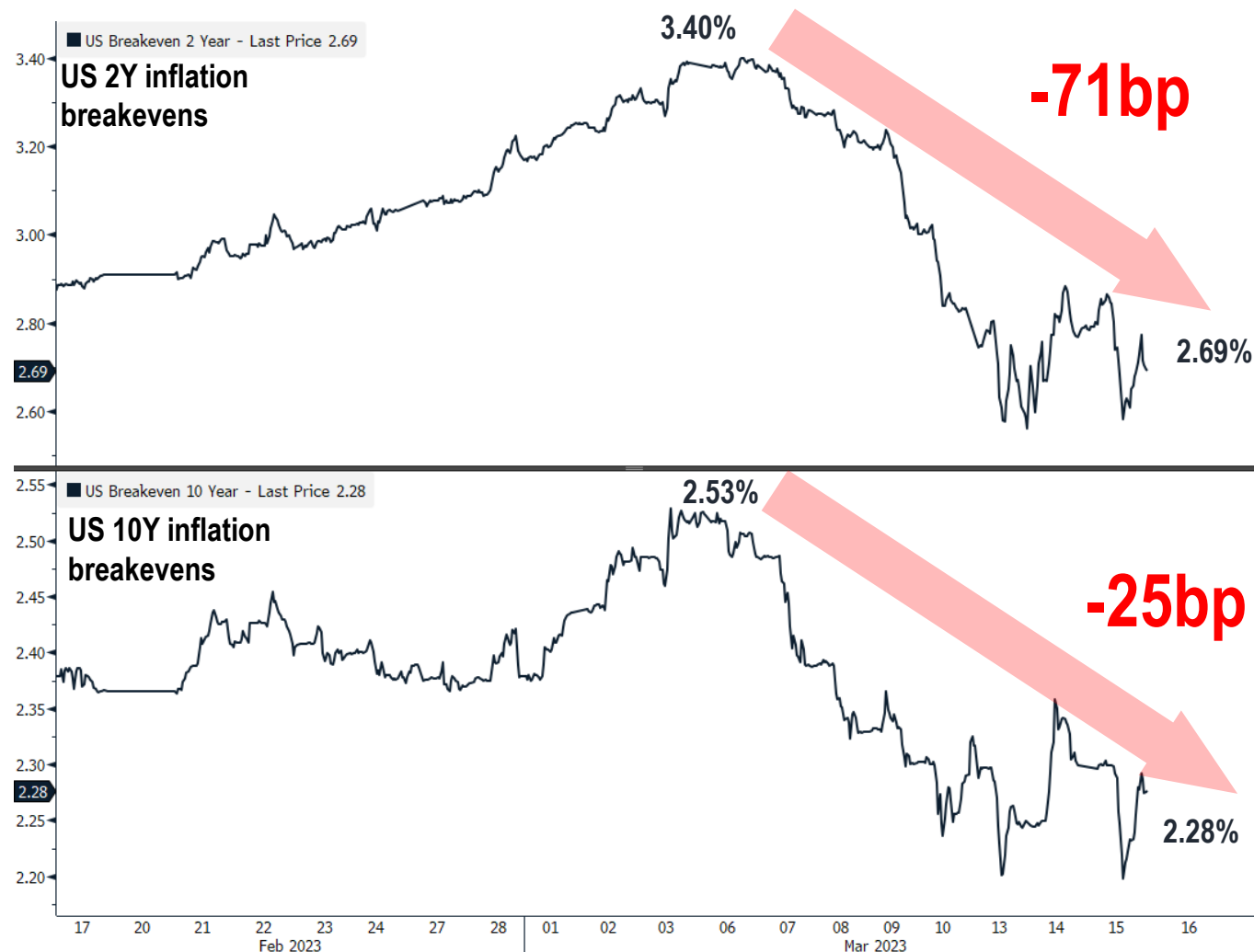
Source: Fundstrat, Bloomberg



BROKEN: Market-based measures inflation falling

INFLATION BREAKEVENS: 2Y and 10Y inflation breakevens

Past month



Source: Fundstrat, Bloomberg



INFLATION: Inflation differential collapsing

INFLATION DIFFERENTIAL: 10Y less 2Y inflation breakevens

Past month



Source: Fundstrat, Bloomberg



SUPPLY CHAINS: COVID-19 “Supply Shock” Completely Erased

Shanghai to LA Shipping Rates (\$/40 ft box)

Since 2011



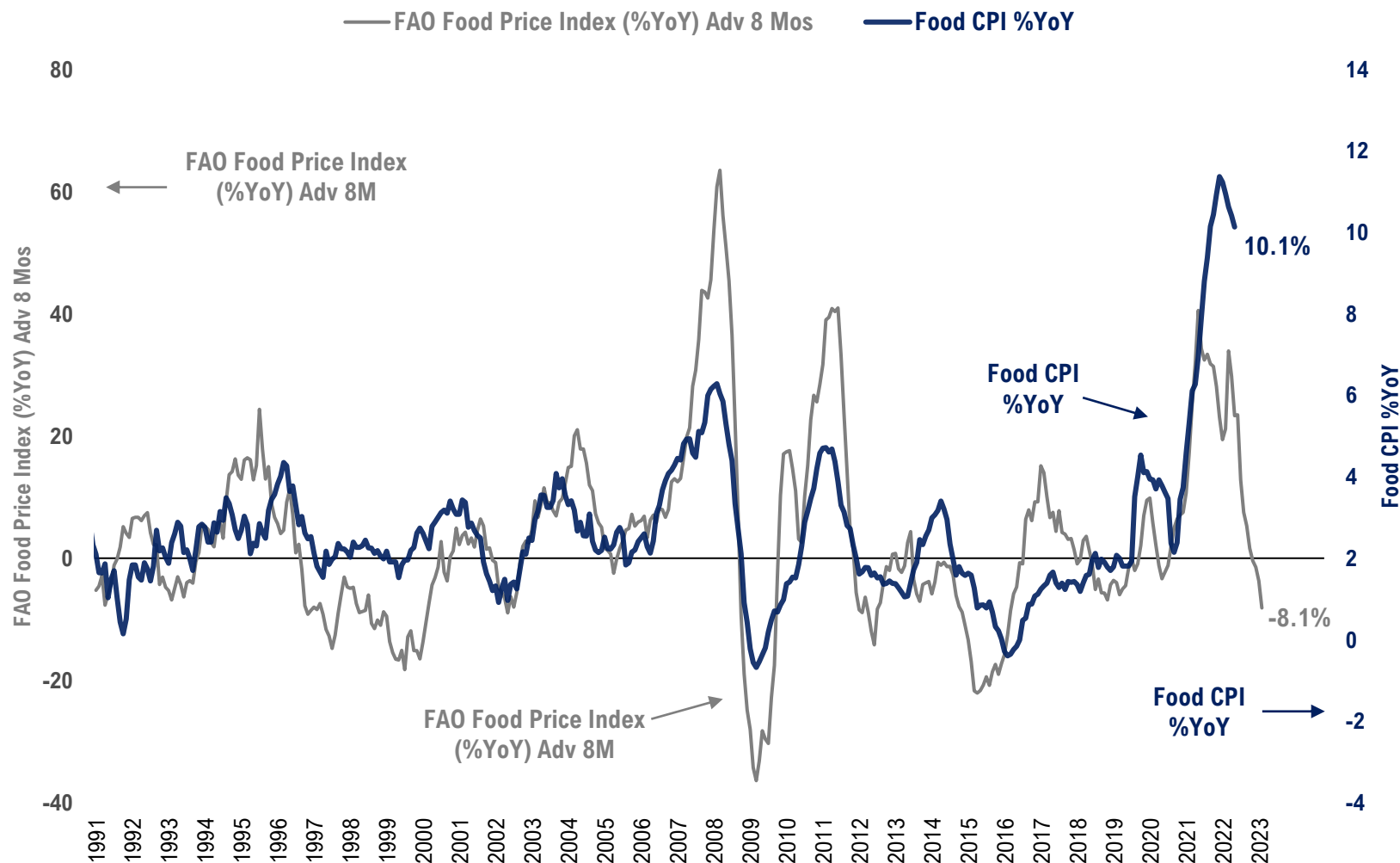
Source: Fundstrat, Bloomberg



FOOD PRICES: FAO Food Price Index Shows Food Deflation YoY

FAO Food Price Index and Food CPI %YoY

Since 1991. FAO Food Price Index advanced by 8 months.

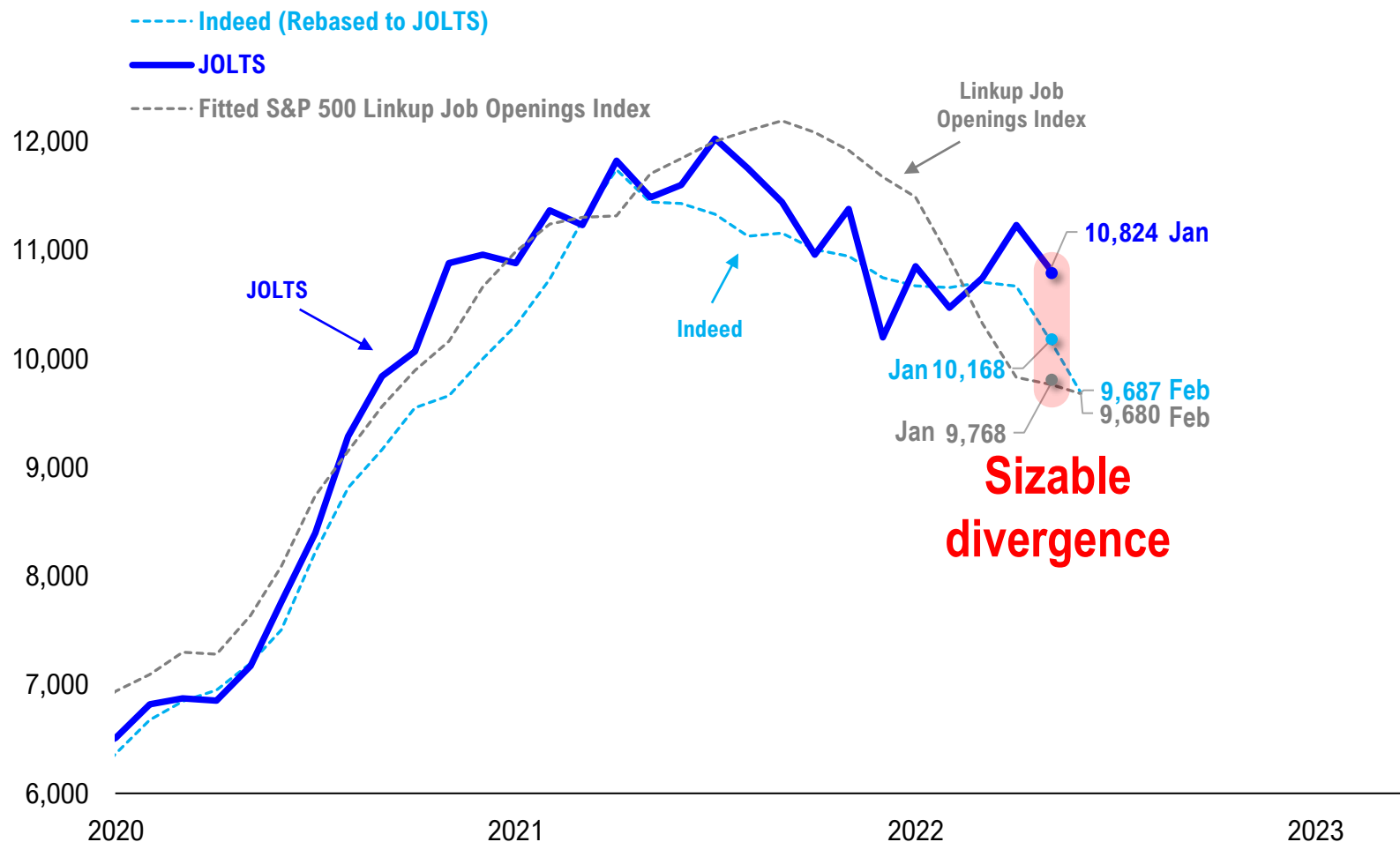


Source: Fundstrat, Bloomberg, BLS, UN Food and Agriculture Organization



JOLTS: Divergence vs LinkUp + Indeed important to watch

S&P 500 LinkUp Job Openings Index, JOLTS, and Indeed
Since 2012



Source: Fundstrat, Bloomberg, BLS, Indeed, S&P, Linkup

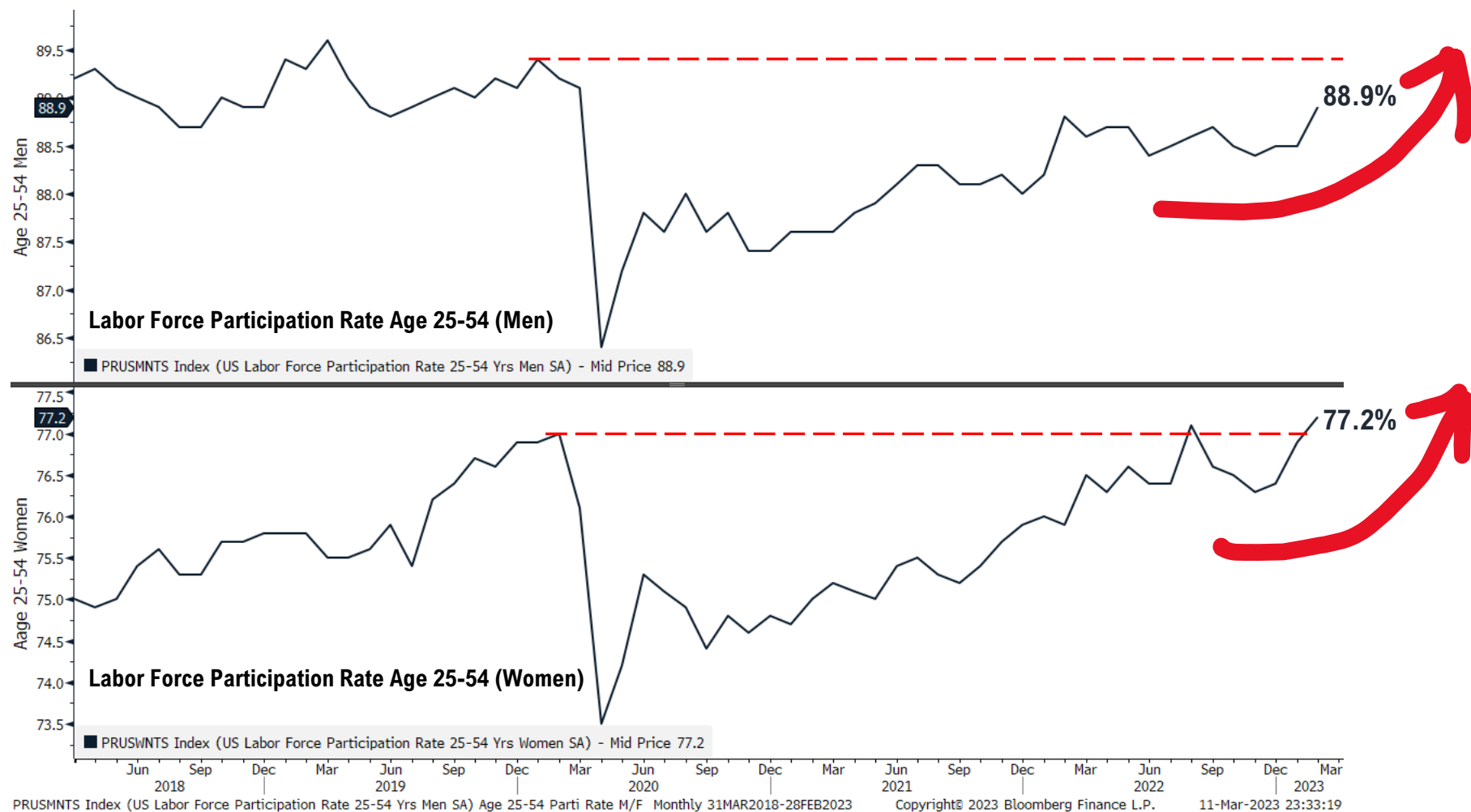
* S&P LinkUp Index fitted to JOLTS via best fit regression.

** Indeed Index Rebased to JOLTS as of 1/31/2020



LABOR: Participation rates improving

US Labor Force Participation Rate 25-54 Years for Men/Women Since 2018



Source: Fundstrat, Bloomberg, BLS

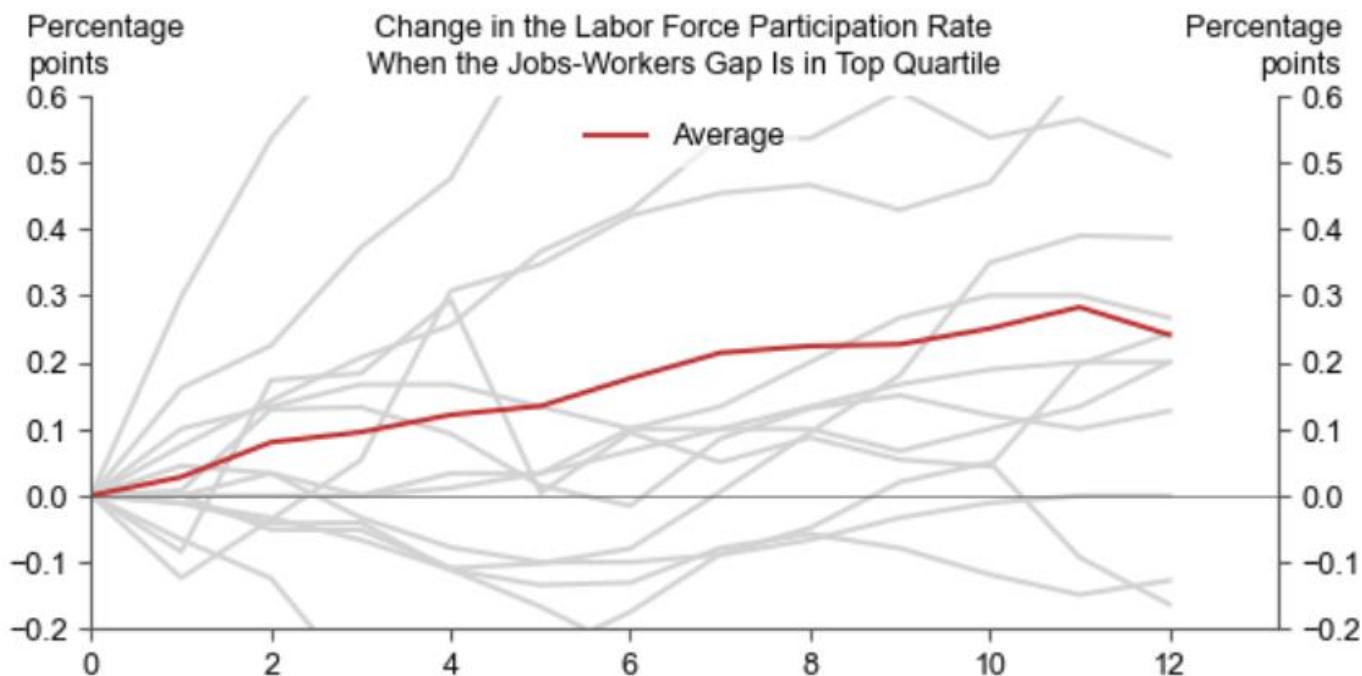


LFPR: Participation Rate Actually Picks up in a Tight Labor Market

Labor Force Participation Rate During Periods of Labor Market Tightness

When Jobs-Workers Gap is in Top Quartile

Exhibit 3: Labor Force Participation Typically Picks Up Modestly During Periods of Labor Market Tightness



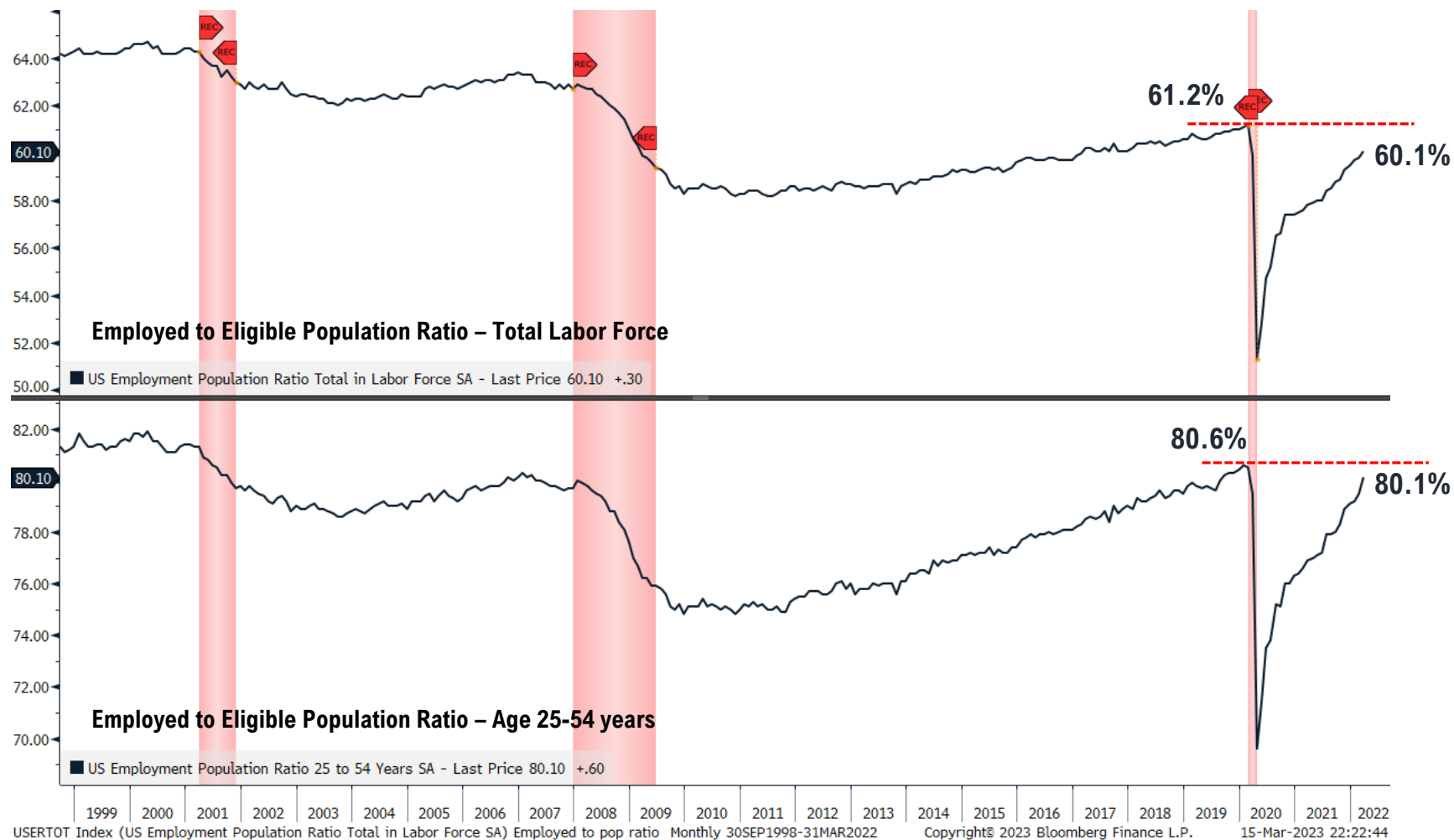
Note: We report instances where the jobs-workers gap is in its top quartile for at least 12 months in the US, UK, Germany, France, and Australia. We use three month moving average labor force participation rates.

Source: Haver Analytics, Goldman Sachs Global Investment Research



LABOR: Employed to population below pre-pandemic

US Employed to Population Ratio Since 2000



Source: Fundstrat, Bloomberg, BLS

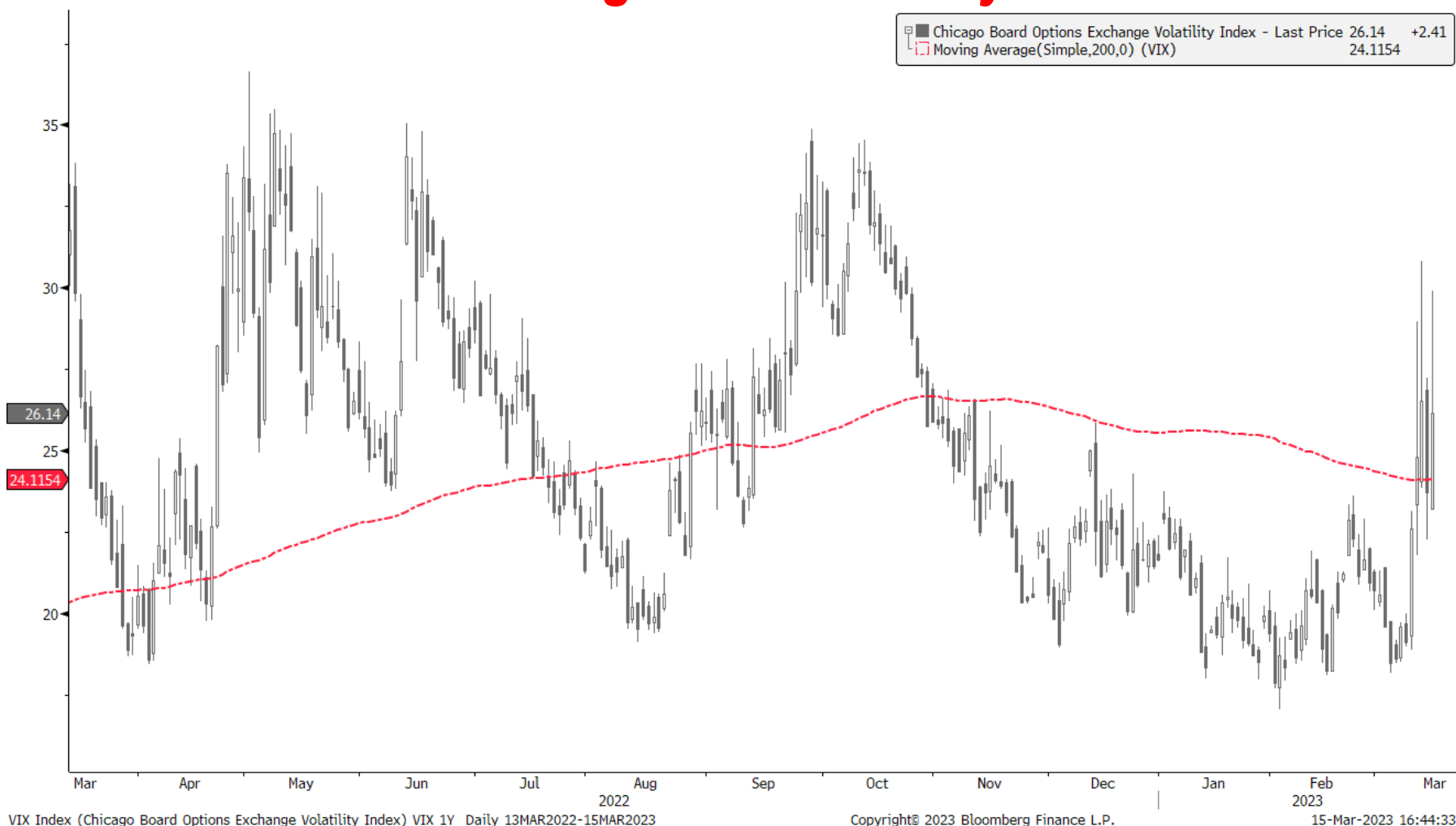


VIX: Surge >30 is a sign of heightened fear...

Figure: VIX

Last year

VIX surge = worst not yet in

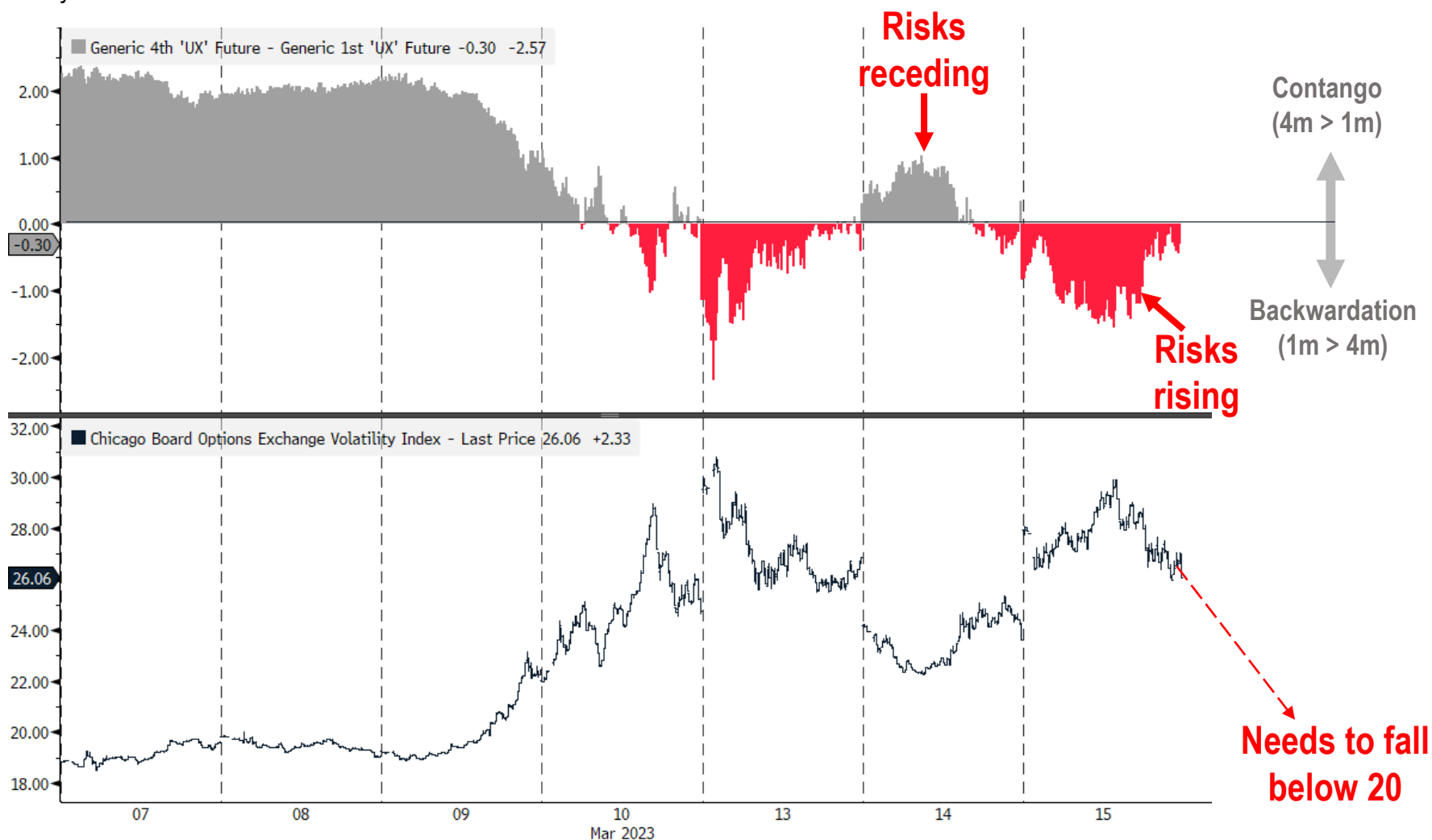


Source: Fundstrat, Bloomberg



VIX: Resumption contango would be sign “worst” of fear behind

VIX – VIX term structure and VIX Daily



UX4 Index (Generic 4th 'UX' Future) VIX and VIX TS 7 Days 5 Minutes

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15-Mar-2023 16:45:29

Source: Fundstrat, Bloomberg



VALUATION: P/E hardly demanding

PE Ratios of FANG+ & GICS Level 1 Sectors

Based on 2024 EPS Estimates

Sector	PE Ratio ('24 EPS)
1 FANG+	23.1x
2 Discretionary ex-FANG+	18.9x
3 Consumer Staples	18.6x
4 Utilities	16.4x
5 Industrials	16.4x
6 Real Estate	16.3x
7 Tech ex-FANG+	16.3x
8 Healthcare	15.5x
9 Materials	15.5x
10 Comm. Services ex-FANG+	10.5x
11 Financials	10.3x
12 Energy	10.1x
S&P 500	15.8x
S&P 500 ex-FANG	14.1x

**Ex-FAANG,
P/E of 14.1X 2024
hardly demanding**

Source: Fundstrat, Bloomberg

* FANG+ includes META, AMZN, NFLX, GOOGL, NVDA, AAPL, MSFT, TSLA

Any S&P 500 Sector with a FANG+ Stock as a constituent has had that company's price and earnings removed from the ratio.



Rule of 1st 5 Days: March + April = Fire

Returns for all years with first 5D >1.4% and neg prior year

Since 1950. N = 7. Average, median, and win ratio excluding 2023

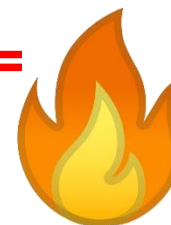
ALL YEARS SINCE 1950 WITH NEG PRIOR YEARS & >1.4% FIRST 5 DAYS

Monthly Performance

	Day 5 -->												Full
	Jan End	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
1958	1.7%	-2.1%	3.1%	3.2%	1.5%	2.6%	4.3%	1.2%	4.8%	2.5%	2.2%	5.2%	38.1%
1963	2.3%	-2.9%	3.5%	4.9%	1.4%	-2.0%	-0.3%	4.9%	-1.1%	3.2%	-1.1%	2.4%	18.9%
1967	4.6%	0.2%	3.9%	4.2%	-5.2%	1.8%	4.5%	-1.2%	3.3%	-2.9%	0.1%	2.6%	20.1%
1975	9.9%	6.0%	2.2%	4.7%	4.4%	4.4%	-6.8%	-2.1%	-3.5%	6.2%	2.5%	-1.2%	31.5%
2003	-6.0%	-1.7%	0.8%	8.1%	5.1%	1.1%	1.6%	1.8%	-1.2%	5.5%	0.7%	5.1%	26.4%
2012	2.5%	4.1%	3.1%	-0.7%	-6.3%	4.0%	1.3%	2.0%	2.4%	-2.0%	0.3%	0.7%	13.4%
2019	5.0%	3.0%	1.8%	3.9%	-6.6%	6.9%	1.3%	-1.8%	1.7%	2.0%	3.4%	2.9%	28.9%
Average	2.9%	0.9%	2.6%	4.0%	-0.8%	2.7%	0.8%	0.7%	0.9%	2.1%	1.2%	2.5%	25.3%
Median	2.5%	0.2%	3.1%	4.2%	1.4%	2.6%	1.3%	1.2%	1.7%	2.5%	0.7%	2.6%	26.4%
Win Ratio	86%	57%	100%	86%	57%	86%	71%	57%	57%	71%	86%	86%	100%
2023	4.7%	-2.6%	-	-	-	-	-	-	-	-	-	-	-

Source: Fundstrat, Bloomberg

**March + April =
Fire**





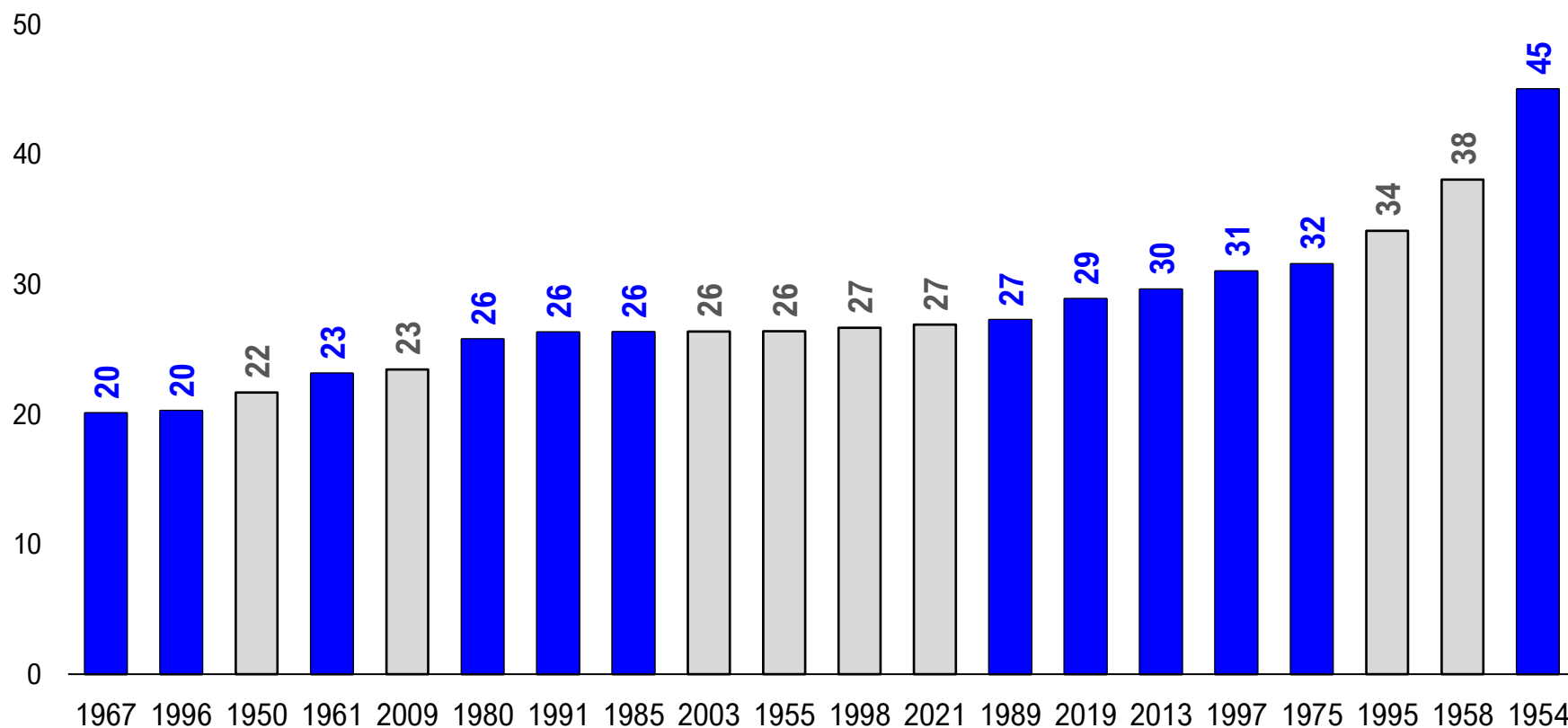
RETURNS: 20% Annual Returns Coincide With Strong Starts

S&P 500 Annual Gains >20% and Returns Through 1W Feb

Since 1950

□ Years When S&P 500 Annual Return >20% (Since 1950) (n= 20)

■ Years When YTD Gain (Through 1W Feb) > 5% (n= 12)



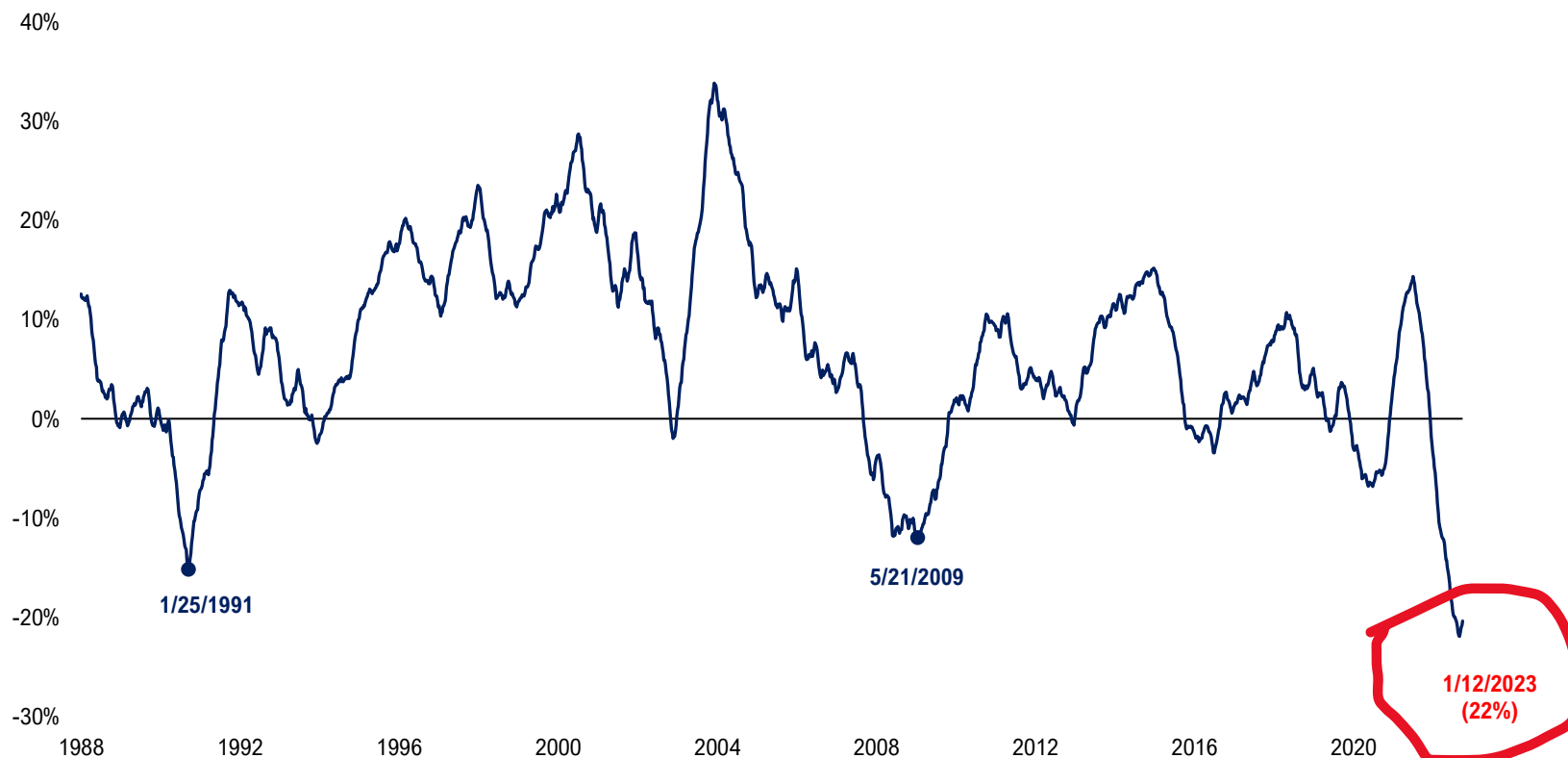
Source: Fundstrat, Bloomberg



SENTIMENT: Retail went ULTRA Bearish in 2022... never more beared up

AAll Bull-Bear Spread (Rolling 52W Average)
Since 1988

Retail investors never been this bearish



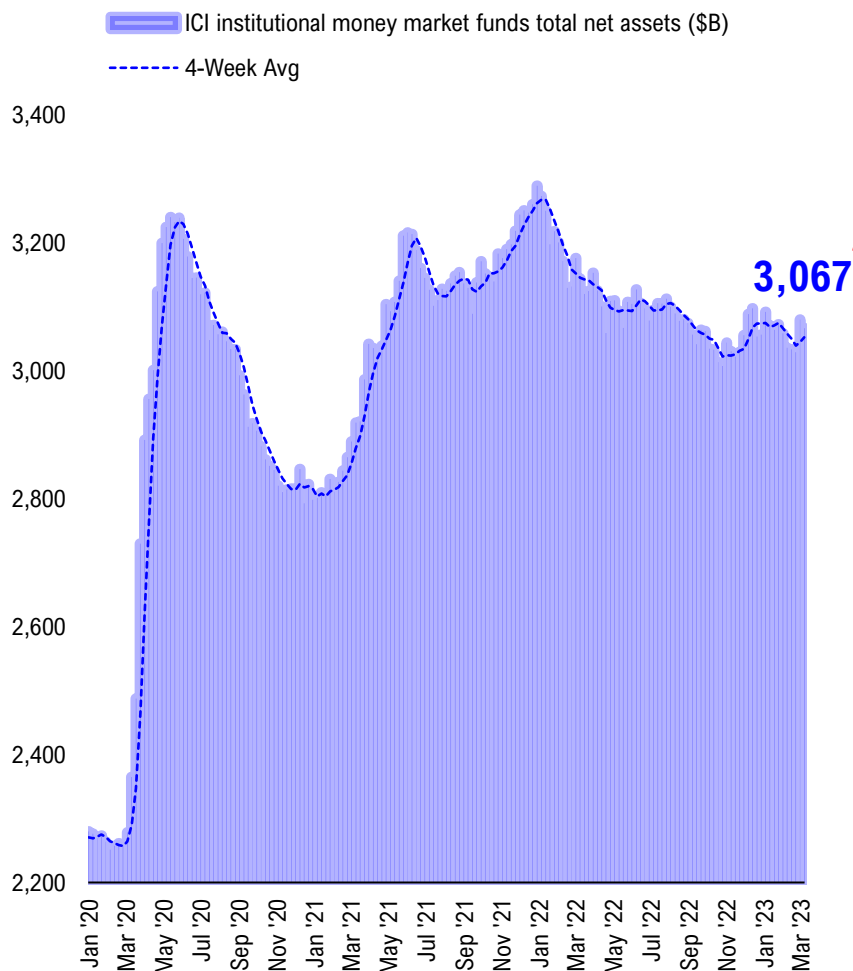
Source: Fundstrat, AAll



RETAIL: Sitting on more cash than pandemic high

Institutional Money Market Fund Assets

In \$ billions. As of 3/8/2023



Retail Money Market Fund Assets

In \$ billions. As of 3/8/2023



Source: Fundstrat, ICI, Bloomberg



TECHNOLOGY: Close to erasing underperformance of 2022

QQQ and FAANG providing ballast for markets

Daily



Source: Fundstrat, Bloomberg



BANKS: P/B < 1.0 but not at GFC lows

S&P 500 GICS 2 Banks P/B
Since 1991



Source: Fundstrat, Bloomberg

These companies have deposits in Silicon Valley Bank. Check list here

🕒 2 Min(s) Read



By Jomy Jos Pullokanan

Mar 12, 2023 5:01:12 PM IST (Published)

- Circle holds \$3.3 billion,
- Roku \$487 million,
- BlockFi \$227 million,
- Roblox \$150 million,
- Ginkgo Bio \$74 million,
- iRhythm \$55 million,
- Rocket Lab \$38 million,
- Sangamo Therapeutics \$34 million,
- Lending Club \$21 million and
- Payoneer \$20 million

Source: Twitter

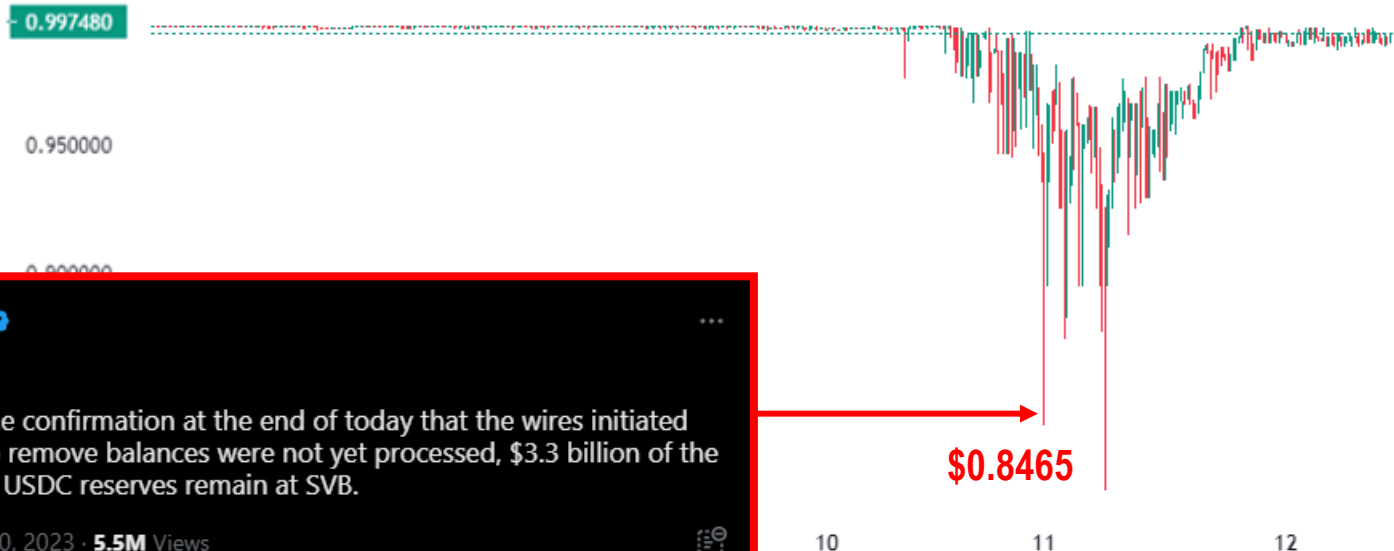


USDCUSD 0.997480 USD +0.008480 +0.86%

USDCUSD chart>

TradingView

</>



Back to
"parity"



Circle
@circle

1/ Following the confirmation at the end of today that the wires initiated on Thursday to remove balances were not yet processed, \$3.3 billion of the ~\$40 billion of USDC reserves remain at SVB.

10:11 PM · Mar 10, 2023 · **5.5M** Views



Circle
@circle · Mar 10

Replying to @circle

2/ Like other customers and depositors who relied on SVB for banking services, Circle joins calls for continuity of this important bank in the U.S. economy and will follow guidance provided by state and Federal regulators.

108 274 1,919 711.9K

Source: Fundstrat, Twitter, TradingView



BITCOIN: Rule #5... Trading >200D moving average

BITCOIN: Above 200D MAVG Since 2019



Source: Fundstrat, Bloomberg



Disclosures

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