March 2023: Market Review

Global financial markets experienced heightened volatility in March as bank failures at a handful of regional U.S. banks and a failure of a large European bank caused investors to fear that the Fed's swift increase in interest rates over the past year had caused systemic financial system risk. In the U.S., Silicon Valley Bank, Signature Bank, and Silvergate Bank all failed in quick succession. The factors that came together to ignite this fire was familiar with other historic banking system problems. These banks invested in longer-dated maturities of primarily U.S. government bond investments to stand behind their customers' demand deposits. This proved fatal when significant customer withdrawals over the past six months from their largely non-FDIC insured depositor base forced these banks to sell their government bonds at prices significantly below par value due to the Fed's accelerated interest rate increases over the past year. As more depositors from similar businesses began sensing problems at these banks, a classic bank run ensued at these financial institutions until the U.S. government stepped in to protect depositors. The FDIC, in coordination with the Treasury and Federal Reserve, crafted a plan to back all deposits at these banks. In addition, the Fed instituted a new lending facility allowing banks to lend below par government bonds at par value for cash. The banking sector then saw the Swiss central bank engineer the takeover of long-suffering Credit Suisse to its main rival UBS over the ensuing weekend. The swift coordinated action from the U.S. government and the Swiss central bank seemed to calm the waters as global equity markets rebounded later in the month.

Despite the cracks in the banking sector, the Fed continued with its fight against inflation and raised the Fed Funds rate by another 25 basis points, bringing it to a range of 4.75%-5.00%. However, the bond market began to price in rate cuts later this year amid the fallout from the banking crisis coupled with softer inflation readings during the month. Both the CPI (+6.0% in February versus +6.4% in January) and PCE data were lower than expected. The Dow Jones Industrial Average (+2.1%) posted the weakest return in March since the index has more exposure to banks than the other domestic large-cap equity indices. The S&P 500 Index climbed +3.7% while the tech-heavy NASDAQ Composite surged +6.8%. Mega-cap technology stocks continue to act as safe havens for equity investors during economic stress due to their strong balance sheets, high growth rates and large levels of cash.

In domestic equity markets, growth stocks significantly outpaced value across all market capitalization sizes. The Russell 1000 Growth Index was up +6.8% for the month versus the Russell 1000 Value Index return of -0.5%. The Russell Midcap Growth Index gained +1.4% while the Russell Midcap Value Index fell -3.2%. The Russell 2000 Growth Index was down -2.5% whereas the Russell 2000 Value Index, which is heavily exposed to small regional banks, sold off -7.2%. Gold prices rallied +8% and closed the month at $1,986 per ounce. WTI crude oil rose in the last week of March and finished the month at $76/barrel, largely unchanged from February despite significant intra-month volatility. Developed international equities trailed their U.S. counterparts despite the depreciation of the U.S. dollar during the month. The MSCI EAFE Index added +2.5% while emerging markets rose +3.0% in March as Chinese equities climbed +4.5% due to a plethora of strong economic data from their economic reopening.

U.S. fixed income markets posted gains in March as the fear surrounding the fragility of the U.S. banking system was enough to cause a rapid decline in the 2-year U.S. Treasury yield. 2-year yields peaked at 5.0% before plummeting over 100 basis points in the five days from the first bank failure announcement (March 8th) until the government backed uninsured deposits (March 13th). The inversion between the 2-year and the 10-year U.S. Treasury notes narrowed sharply to -0.58%. The spread between the 3-month and the 10-year U.S. Treasury notes widened to -1.37% as the Fed hiked interest rates. The Bloomberg Aggregate Bond Index posted a gain of +2.9% while the Bloomberg U.S. Corporate High Yield Bond Index was up +1.1%, indicating that credit spreads widened in March.

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See footnotes on the following page.

U.S. equity and fixed income markets seem to have weathered the mini-shockwave this month that seemed somewhat reminiscent of the Great Financial Crisis of 2008: a sell-off in risk assets fueled by the fear of a widespread crisis in the banking industry. However, the market began viewing this differently than 2008 after the few U.S. banks that failed were shown to have had elevated levels of uninsured depositors, concentrated depositor bases, and very high-quality assets from a credit perspective (very unlike 2008). These failed banks seemed to be quite different than most other regional banks with diversified deposit customer profiles and much higher levels of insured deposits. While future profits for banks were downgraded and regulators took ample grief for not having highlighted these problems at the failed banks, the swift action of the U.S. Treasury and Federal Reserve to back these depositors and assist banks with loans at par value on government securities stabilized markets. The crisis seems to have been corralled as there have been no further runs on banks. The economy continues to show strength as the labor market added 311,000 jobs in February and consensus estimates expect positive real GDP growth for the first quarter.

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