Summary

Economic news for the week included the Federal Reserve raising rates another quarter-percent, durable goods orders falling back, mixed to slightly better housing data, and little change in jobless claims.

Global stocks saw positive returns last week, as some banking concerns abated, along with hopes for central banks easing hawkish policies. Bonds fared positively as well. Commodities rose in price across the board with help from a weaker dollar.

Economic Notes

(0) As noted earlier in the week, the **FOMC** raised rates by 0.25% to 4.75-5.00%. However, odds of another hike in May have now shrunk to below 20%, with high probability of a rate cut by July. In fact, Fed Chair Powell acknowledged during his press conference that a pause was considered this meeting, but ultimately rejected. Market consensus appears to be that the Fed could be close or at their ending point, with the 'dot plot' showing the Fed funds rate estimates topping out just over 5.0% in 2023. This was brought about by slow but steady improvement in inflation, but also high chances of strong slowing effects from tighter credit—for the latter, stress on the banking system tells the Fed (quite directly) that hiking has been working. However, estimates are all over the place between members for 2024-25—in a range as wide as 2% from low to high—showing a general downward trend toward neutral (2.5%) over the next few years. It's also important to note the difference (for bond markets) between a pause at a high level, and an actual ease—after hikes end, this will be the next conundrum for markets to sort out.

Of course, there are inconsistencies between the Fed's overall message and where member estimates fall. This is the problem with highly specific releases like the dot plots. For example, the economy is already growing at a faster rate in Q1 (via Fed real-time estimates) than is implied by their full-year 2023 median forecast of 0.4%. For the math to work, this implies growth will have to drop off in later quarters this year, the type that could coincide with recession.

(-/0) **Durable goods orders** in February fell by -1.0%, in contrast to an expected 0.2% gain, but was an improvement on January's -5% drop. Removing transports resulted in no change from last month, while core capital goods orders rose 0.2%, beating expectations of a -0.2% drop. For Feb., gains were seen in metals and electrical components, while defense and non-defense aircraft/parts fell back sharply—a group with lumpy month-to-month-results. Over the past year, overall orders were up 2%, while shipments rose 6%.

(+) **Existing home sales** for February rose 14.5% to a seasonally-adjusted annualized rate of 4.58 mil. units, which exceeded expectations of a 5.0% gain. This was the strongest single-month increase in almost 3 years, although the year-over-year sales pace remains down -23%. Sales for single-family units rose 15% in the month, double the pace of condos/co-ops, with gains seen in all four national regions. The median home price fell by a few tenths on a year-over-year basis to $363,000, which is also down -4% from the May 2022 peak. However, months' supply fell back to 2.6, especially with homes available for sale now again down below levels seen prior to the pandemic. Mortgage rates were reported by the NAR at a level of 6.6% in mid-March, down from the peak, but well over 4% from last March. As stated almost every month, normally, a spike in financing rates would cause a lot more damage in real estate markets, but the lack of inventory has been just as persistent to sustain sales somewhat.

(0) **New home sales** in February rose by 1.1% to a seasonally-adjusted annualized rate of 640k units, surpassing the expected decline of -3.1%. Unfortunately, a sizable downward revision for the prior month (-5%) took away most of the positivity, in keeping with a -19% decline in new home sales over the past year. Gains in the month in the West and South offset a decline in the Northeast, likely weather-related this time of year. Months' supply ticked down to 8.2, although inventories have started to slowly rise.

New home sales continue to fall short of the approximate 1 mil. units needed annually to keep pace with demographic supply needs, taking account of organic inventory reductions like teardowns. Additionally, many current homeowners, financed through years of low-rate mortgages, are reluctant to give these loans up. Homebuilders continue to be more conservative in activity post-2008, in addition to the ongoing difficulty in finding qualified workers, which has been noted in anecdotal comments in the Federal Reserve's Beige Book and other sources. No doubt the spike higher in financing costs has weighed on risk-taking here as well.

(0) **Initial jobless claims** for the Mar. 18 ending week ticked down by -1k to 191k, below the 197k level forecast. Continuing claims for the Mar. 11 week rose by 14k to 1.694 mil., just above the 1.690 mil. consensus expectation. Aside from ongoing seasonal adjustments issues thus far this year, little has changed, demonstrating a strong labor market with few layoffs overall in the economy.

Question of the Week

Why have short-term U.S. Treasuries been acting so strangely?

Actually, they haven't been, after looking at the assumptions behind market yields. They're reflecting fast-changing shifts in expectations, as uncertainty about future rates is as high as it's been in a while. So, demand for certain maturities has changed just as quickly. That said, the move in the 2-year Treasury has been dramatic, with yields falling from 5.0% on March 8 to 3.8% by Friday—a very quick turnaround in sentiment—with a few 1-day moves the largest in 40 years.

In normal conditions, a yield curve's positive slope demands that long-term Treasury bonds offer higher yields than short-term Treasury bills. Investors demand more yield for taking on the risk and uncertainty of longer time periods (tied to uncertainty in inflation and economic growth), as well as other unique supply/demand factors of certain bond market participants. When the curve is inverted, it turns the bond market on its ear, as it does to the banking system, as we've seen this month.

By contrast, short-term rates reflect where market expectations lie for Fed funds over the near-term, as opposed to longer-term secular expectations. These have wavered dramatically in March, from assumptions of ongoing hikes to now-assumed cuts that could accompany a recession. The uncertainty over *when* this would happen has caused the dramatic shift most notably from the 6-month to 2-year parts of the curve, in addition to investors racing to grab 5%-esque yields before they potentially disappear.

Some investors have chosen to lock in those high yields via T-bills directly or CDs (which loosely track T-bill yields). While default isn't considered a threat, there are other two-way risks: (1) if rates continue to move higher, investors will have locked in a lower rate, losing out via opportunity cost, and better performance would have been had in a money market mutual fund with a variable rate, for example; but (2) if rates fall from here, having locked in now solidifies the higher attractive yield for longer. How long is long enough? That is the ongoing dilemma when investing cash-like assets, with need for potential liquidity a key consideration. The behavioral finance notion of 'regret' is probably unavoidable. When the T-bill or CD matures, the market rate at that time will provide more information in the form of reinvestment risk, but of course we only know the correct answer of fixed vs. variable with the benefit of hindsight.

Market Notes

Period ending 3/24/2023	1 Week %	YTD %
DJIA	1.18	-2.21
S&P 500	1.41	3.86
NASDAQ	1.68	13.22
Russell 2000	0.53	-1.18
MSCI-EAFE	1.59	4.28
MSCI-EM	2.23	1.97
Bloomberg U.S. Aggregate	0.52	3.44

U.S. Treasury Yields	3 Mo.	2 Yr.	5 Yr.	10 Yr.	30 Yr.
12/31/2022	4.42	4.41	3.99	3.88	3.97
3/17/2023	4.52	3.81	3.44	3.39	3.60
3/24/2023	4.74	3.76	3.41	3.38	3.64

U.S. stocks calmed from the prior week, with some abating stress from the banking woes and lower interest rates helped sentiment. By sector, leaders included communications, materials, and energy, although defensive staples and health care were right behind. Utilities and real estate were the two sectors that lost ground, with the latter tied to concerns over expected tighter bank financing for commercial properties.

Communication has been used by Fed and Treasury officials increasingly over the years, with mixed success in calming nerves or shaping expectations (the latter is where it's formally described as 'forward guidance'). Wednesday's FOMC first saw stocks rebound higher after the FOMC decision to raise rates, even while Chair Powell gave the impression that rate cuts were not in the cards this year. This rebound didn't last long, though, as U.S. Treasury Secretary Yellen told the Senate around the same time that while the banking situation is stabilizing, blanket deposit insurance coverage was not being discussed at this time. The latter comments were blunt, yet realistic, but not taken as well by markets, causing a swift -2% downward reversal. (The insurance issue is up to Congress to decide, as it gets politically more complicated if intended to be on a longer-term industry-wide basis.) Banking stresses create a variety of messy issues, some of which are criticized as political. Another is Congressional pushback against bailing out U.S. banks taking on too many risks.

A risk on the side of tighter government regulation of banks, such as in the nationalization of deposit insurance, is that it could turn banks from profit-seeking businesses into more like regulated utilities (a long-standing fear from the industry, especially following crises). Markets, of course, would prefer little regulatory oversight, but also full backstops should things go wrong—a recipe for expensive moral hazard. Banks have been borrowing from the new Bank Term Funding Program at a rate of over $160 bil./week over the last few weeks—a sizeable amount—but also demonstrating that the targeted tool has been effective.

Foreign stocks outperformed U.S. last week in all segments, with help from a weaker U.S. dollar, as well as expanding PMI composite results in Europe. The financial sector has continued to experience volatility after the banking events of the prior weekend in Switzerland. In other markets, UK raised rates by 0.25% as inflation fears eased a bit, while China lowered rates by -0.25%, to likely project a stronger pro-growth signal. Emerging markets were mixed on the week, with gains in Asia offset by a decline in Brazil.

The Swiss National Bank facilitated a takeover of Credit Suisse by UBS, which helped alleviate further concerns of a global banking contagion for now. While this appeared to be done relatively quickly and cleanly, legal questions remain about certain subordinated Credit Suisse bond tranches (known as AT1) being wiped out, which was the purpose of the AT1 tranche. However, some stockholders were eased into UBS shares. Ironically, the deal strongly benefitted some senior CS bondholders, which were eased into higher-rated UBS

backing. Ironically, the SNB raised rates by 0.50% just days after the merger to combat continued inflation pressures.

Bonds gained last week, as interest rates were flat to lower across the middle of the yield curve, but rose on the short and long ends. Investment-grade corporates fared best, while foreign bonds also gained along with the dollar.

Commodities gained across the board last week, notably in energy and industrial metals, helped by a weaker dollar as well. Crude oil rose over 3% last week to $69/barrel, in a choppy week along with mixed expectations for a recession this year and concerns over oversupply, as the U.S. government noted the Strategic Petroleum Reserve may take a few years to refill.

Have a good week.

Ryan M. Long, CFA
Director of Investments
FocusPoint Solutions, Inc.

Sources: FocusPoint Solutions, American Association for Individual Investors (AAII), Associated Press, Barclays Capital, Bloomberg, Citigroup, CME Group, Deutsche Bank, FactSet, Financial Times, First Trust, Goldman Sachs, Invesco, JPMorgan Asset Management, Marketfield Asset Management, Morgan Stanley, MSCI, Morningstar, Northern Trust, PIMCO, Standard & Poor's, StockCharts.com, The Conference Board, Thomson Reuters, T. Rowe Price, Univ. of Michigan, U.S. Bureau of Economic Analysis, U.S. Federal Reserve, Wall Street Journal, The Washington Post. Index performance is shown as total return, which includes dividends. Performance for the MSCI-EAFE and MSCI-EM indexes is quoted in U.S. Dollar investor terms.

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Notes key: (+) positive/encouraging development, (0) neutral/inconclusive/no net effect, (-) negative/discouraging development.