

MARKET UPDATES

[March 17, 2023: Recorded Leadership Discussion Featuring: Regions Chief Economist, Chief Investment Officer, and Chief Market Strategist.](#)

[March 24, 2023: Join the upcoming live Regions Market Update.](#)

KEY OBSERVATIONS

Stocks: A Bounce Amid Oversold Conditions; Small-Caps, High Yield Bonds, 'Value' Underperformance Point Toward Economic Growth Concerns.

Domestic equities entered last week in oversold territory after the prior week's selloff, an optimal setup for a bounce at the very least. The S&P 500 closed 1.4% higher last week at 3,916 after trading between 3,850 and 3,950 over the balance of the week, and from a technical perspective, the S&P 500's 200-day moving average at 3,940 remains key upside resistance. While the S&P 500 turned out a modest weekly gain, under the surface, we view the price action as far less constructive as breadth was narrow and the equal-weight S&P 500 trailed the market cap-weighted S&P 500 by 1.7%. Small-cap stocks lagged the S&P 500 again last week, the Russell 2000 index falling 2.5%. The weakness appears driven by expectations banks will tighten lending standards in coming months, leading to higher funding costs or less access to credit for smaller companies typically more reliant on bank financing. The underperformance of small-cap stocks, widening credit spreads on high yield corporate bonds, and economically sensitive value sectors lagging by a considerable margin on the week all point toward building economic growth concerns. We remain concerned valuations are too rich, broadly speaking, and maintain a preference for quality, expecting volatility and uncertainty to weigh on investor sentiment and risk appetite near term.

Bonds: Market Participants Front-Run Expected Future Fed Rate Cuts, Force Treasury Yields Lower.

Last week brought with it more volatility in the Treasury market and again with a downward bias to yields, particularly on the front-end of the yield curve. In just two weeks' time, market participants have pivoted from pricing in the prospect of a near-6% Fed funds rate by year-end 2023, to now pricing in rate cuts starting in June with 100-basis points being expected through year-end in the wake of multiple banks entering FDIC receivership. While directionally this shift makes sense given recent news flow, the magnitude of the move lower in short-term Treasury yields appears extreme, particularly with February's CPI pointing toward continued elevated and sticky inflationary pressures. The FOMC finds itself between the proverbial rock and a hard place this week as it must convince markets that it has the tools at its disposal to balance financial stability with the price stability component of its dual mandate. Barring additional banks entering FDIC receivership over coming days, we expect the FOMC to hike the Fed funds rate by 25-basis points while trying to maintain optionality surrounding future policy moves.

WHAT WE'RE WATCHING

- The Federal Open Market Committee (FOMC) concludes its two-day meeting on Wednesday and is expected to narrowly approve an increase in the Fed funds rate by 25-basis points to a range of 4.75% to 5.00%.

- U.S. Purchasing Managers Index (PMI) for March is released Friday and the Composite reading is expected to fall to 49.4 from 50.1 in February. Manufacturing PMI is expected to remain in contraction at 47.3, in-line with the February reading, while Services PMI is expected to fall modestly to 50.3 during the month from 50.6 in February, barely remaining in expansion territory.

- Eurozone Market Purchasing Managers Index (PMI) Composite for March is also released Friday and is expected to fall to 51.9 from 52.0 in February. Services PMI is expected to fall to 52.5 from 52.7 in February, while Manufacturing PMI is expected to rise to 49.0 from 48.5 the prior month.

	Price/Yield			Total Return (%)			
	3/17/2023	1 Week Ago	1 Month Ago	Year to Date	1 Year	3 Years	5 Years
Dow Jones Industrial Average	31861.98	-0.11	-5.57	-3.32	-5.60	16.86	7.62
S&P 500	3916.64	1.47	-3.84	2.81	-9.72	17.55	9.51
NASDAQ	11630.51	4.44	-1.24	12.20	-13.78	17.57	10.66
Russell 2000 Index	1725.89	-2.58	-11.17	-1.12	-15.19	17.40	3.22
MSCI World ex US	284.50	-2.24	-4.68	1.23	-7.63	13.02	1.69
MSCI EM	951.56	-0.26	-4.61	-0.20	-12.30	7.70	-1.91
Bloomberg US Aggregate	4.36	1.43	1.82	2.54	-5.33	-2.35	1.00
Bloomberg Global Aggregate	3.48	1.65	1.78	2.31	-9.04	-3.34	-1.35
Bloomberg US Corporate	5.30	0.76	0.96	2.11	-6.36	-0.60	1.52
Bloomberg 10-Year Muni	3.35	0.78	1.12	1.99	-1.73	0.54	1.95
Bloomberg High Yield	8.98	-0.42	-0.72	0.93	-4.98	5.20	2.75

	Price/Yield						
	3/17/2023	1 Week Ago	1 Month Ago	12/31/2022	1 Year Ago	3 Years Ago	5 Years Ago
SOFR (yield)	4.55	4.55	4.55	4.30	0.30	0.54	N/A
30 Year Mortgage (average rate)	6.97	7.02	6.83	6.66	4.48	4.00	4.30
2 Year Treasury (yield)	3.78	4.59	4.62	4.43	1.91	0.49	2.29
10 Year Treasury (yield)	3.40	3.70	3.81	3.87	2.17	1.08	2.84
30 Year Treasury (yield)	3.63	3.71	3.87	3.96	2.47	1.68	3.08
WTI Crude (closing price)	66.74	76.68	76.34	80.26	102.98	26.95	62.34
Brent Crude (closing price)	72.97	82.78	83.00	85.91	106.64	28.73	66.21
Gold (NYM \$/oz)	1973.50	1867.20	1840.40	1826.20	1943.20	1525.80	1312.30

Source: Bloomberg (3- and 5-Year Returns Annualized)

WHAT HAPPENED LAST WEEK?

Stocks: A Bounce Amid Oversold Conditions; Small-Caps, High Yield Bonds, 'Value' Underperformance Point Toward Economic Growth Concerns.

Domestic equities entered last week in oversold territory after the prior week's selloff, an optimal setup for a bounce at the very least. The S&P 500 closed 1.4% higher last week at 3,916 after trading between 3,850 and 3,950 over the balance of the week, and from a technical perspective, the S&P 500's 200-day moving average at 3,940 remains key upside resistance. While the S&P 500 turned out a modest weekly gain, under the surface, we view the price action as far less constructive as breadth was narrow and the equal-weight S&P 500 trailed the market cap-weighted S&P 500 by 1.7%. Small-cap stocks lagged the S&P 500 again last week, the Russell 2000 index falling 2.5%. The weakness appears driven by expectations banks will tighten lending standards in coming months, leading to higher funding costs or less access to credit for smaller companies typically more reliant on bank financing. The underperformance of small-cap stocks, widening credit spreads on high yield corporate bonds, and economically sensitive value sectors lagging by a considerable margin on the week all point toward building economic growth concerns. We remain concerned valuations are too rich, broadly speaking, and maintain a preference for quality, expecting volatility and uncertainty to weigh on investor sentiment and risk appetite near term.

- While one week is a small sample size, the outperformance generated by both growth-oriented and defensive sectors got our attention. The S&P 500 rose 1.4% on the week led by the communication services and information technology sectors each surging 5% or more. The constituent companies included in these growth sectors are capable of growing revenue and earnings in a more adverse economic environment. At the same time, defensive sectors also fared relatively well with utilities the big winner rising 2.3%, outperforming the S&P 500 as Treasury yields fell. However, valuations for some of the largest companies by market cap are 1.5 to 3 times the 18.7X projected 2023 earnings of the S&P 500, and while a premium of some sort is justified due to growth prospects and operational consistency, how much of a premium is warranted remains to be seen. With great expectations and lofty valuations come the prospect of larger declines if those expectations fail to be met or exceeded, and at some point, valuations will matter.
- The S&P 500 financial services sector continued to trade poorly last week, falling another 2% as business models and future profitability for the banking sector received more scrutiny. In the wake of the SVB collapse, it is reasonable to expect both banks and their regulators to focus on addressing funding and interest rate risks for small/mid-size institutions, which could lead to tighter lending standards/fewer loans being made, along with higher deposit costs as banks shore-up liquidity. Taken together, these variables could serve to increase costs for banks and lower profitability, while higher funding costs and less access to capital will likely lead to earnings revisions for both the S&P 500 as well as small and mid-cap (SMid) U.S. companies.
- Developed markets abroad lagged last week as concerns surrounding balance sheet quality at Credit Suisse plagued euro area indices, and the European Central Bank's (ECB) decision to move forward with a 50-basis point rate hike amid elevated inflation weighed on risk appetite. Country indices tied to France, Germany, Italy, Spain, and the U.K. each fell 1.5% or more on the week, with Italy and the U.K. each down 3% or more. Over the weekend, UBS reached an agreement to purchase Credit Suisse for \$3.2B in an all-stock transaction, a substantial discount relative to where the shares were trading at the end of last week. While the Credit Suisse situation was resolved, the fact that UBS acquired the bank in a take-under, and only with the Swiss National Bank offering \$100B of liquidity to UBS to sweeten the deal is evidence that uncertainty is likely to further weigh on risk appetite and cash/liquidity remains king for most.
- Gold has staged an impressive rebound month-to-date, rising 8.5% as interest rates have fallen and investors have desired safety above all else. Gold may be set up to perform well on a relative basis over coming

quarters as uncertainty on several fronts persists, and with Treasury yields now sharply lower since the start of the month, the opportunity cost of holding gold, an asset with storage costs tied to it that turns off no income stream, has been lowered. Gold, specifically, holds appeal as a store of value, particularly with inflationary pressures persisting and with the likelihood of a FOMC pause or pivot in the back-half of this year rising in the wake of SVB's demise. Broadly speaking, we believe real assets remain a valuable diversification tool in portfolios as exposure can help reduce volatility and mitigate potential portfolio drawdown, but a dynamic and tactical approach to the space remains a requirement, in our view.

Bonds: Market Participants Front-Run Expected Future Fed Rate Cuts, Force Treasury Yields Lower.

Last week brought with it more volatility in the Treasury market and again with a downward bias to yields, particularly on the front-end of the yield curve. In just two weeks' time, market participants have pivoted from pricing in the prospect of a near-6% Fed funds rate by year-end 2023, to now pricing in rate cuts starting in June with 100-basis points being expected through year-end in the wake of multiple banks entering FDIC receivership. While directionally this shift makes sense given recent news flow, the magnitude of the move lower in short-term Treasury yields appears extreme, particularly with February's CPI pointing toward continued elevated and sticky inflationary pressures. The FOMC finds itself between the proverbial rock and a hard place this week as it must convince markets that it has the tools at its disposal to balance financial stability with the price stability component of its dual mandate. Barring additional banks entering FDIC receivership over coming days, we expect the FOMC to hike the Fed funds rate by 25-basis points while trying to maintain optionality surrounding future policy moves.

- The FOMC finds itself in a tough spot when it meets this week as a failure to hike the Fed funds rate will likely be interpreted by market participants as the Committee being fearful or even aware of additional shoes to drop in the banking sector, which would not inspire confidence that the Committee has inflation under control. On the other hand, if the Committee hikes, it will be viewed as tone deaf and responding to stale/lagging data on the inflation front instead of focusing on financial conditions/stability in the banking sector, which would also weigh on investor sentiment. The Committee is attempting to thread a microscopic needle and Chair Jerome Powell will need to summon communication superpowers in his post-meeting press conference to avoid a negative market interpretation/reaction to the FOMC's decision.
- Prior to last Thursday, Fed funds futures viewed the eventual outcome of this week's FOMC meeting as a coin-flip between either a 25-basis point rate hike or the Committee pausing due to uncertainty surrounding liquidity concerns in the banking space. Given that the Fed has been in a media blackout period since the onset of the SVB Financial issue, the market has been flying blind surrounding how liquidity concerns in the banking sector might impact this week's decision, spurring 20-basis point-plus daily moves in 2-year Treasury yields over the balance of the week. Rate volatility should calm down somewhat after this week's meeting, but the Committee needs to leave itself some breathing room and optionality regarding the path forward for monetary policy, so it may only be relative calm that is observed over the near-term.
- The release of the February Consumer Price Index (CPI) last Tuesday showed a 0.5% month over month increase in the core reading, topping the consensus estimate of 0.4%, with core CPI rising 5.5% year over year, down only slightly from a 5.6% reading for January. Headline CPI rose 0.4% month over month and 6.0% year over year, both readings were in-line with the consensus estimate. From the FOMC's perspective, core inflation data remains too hot and sticky for comfort, and on the surface would provide the Committee with the cover to raise the Fed funds rate by at least 25-basis points this week, but with financial stability taking precedent, it is far from a slam dunk that the Committee will do anything other than pause and reevaluate.

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