Fortune Favored the Bold

With stocks up over 3% last week, fortune clearly favored the bold. The commodity complex also did well across the board with WTI leading the way (up almost 10%). I could have titled this report "**Being Cautious Didn't Pay the Bills Last Week"**, but that doesn't do justice to the strength that we saw at the end of last week (and for the entire quarter) in some of the riskier segments. ARKK is up 29% on the year and Matt Damon's bitcoin is up over 70% since January 1st (40% since early March when banking fears first hit markets). By no means have we been cautious during this entire quarter, but we did enter last week advising caution and have to decide if this is where we still want to hang our hats.

While I truly hope that I don't have to endure a new series of "Fortune Favors the Bold" commercials, I have to give a hat-tip to those who said "buy bitcoin because banks weren't safe". I never believed that and still don't (as a depositor), but it has played out well in social media and doesn't seem as far-fetched today as it did in February.

The MOVE Index (a measure of Treasury market implied volatility) **plummeted** from a high of almost 200 on March 15th to 135 (128 is the 1-year average). A semblance of normalcy has returned to the Treasury market and last week you could have gotten up and grabbed a cup of coffee and not have seen the 2-year move 20 bps while you were briefly off the desk.

The strength in equities was likely boosted by month-end/quarter-end buying coinciding nicely with weekly (and a slew of daily) options expirations.

Banks

While it is time to Move Beyond Banks (where we highlight shipments, inventory, and delinquencies as well as the upcoming earnings season), we need to start with banks.

Even after a 3% positive week for stocks, none of the issues in I Know What You Did Last Winter have been resolved.

The one issue that I am looking out for is how companies, banks, and individuals respond to the divergence in short-term rates. This includes SOFR at 4.82%, T-Bills around 4.5%, bank deposits below 1%, and bitcoin/stable coins at 0%.

While this is not an "'urgent" issue, it is not glacier-like in its pace either. This may explain why KRE (SPDR Regional Banking ETF) barely rallied in an otherwise risk-on week. If having to compete on deposit rates becomes an issue, it would be a drag on banks of all sizes.

It is impressive that the broad market shrugged off ongoing risk concerns at mid-size banks (based on KRE movement), but the risks mentioned last week are affecting much more than just small and mid-sized banks. While these risks remain in the background, I suspect that they have a reasonable chance of being brought to the foreground again.

Inflation

I am not worried about a return of inflation fears. The PCE deflator came in below expectations (0.3%) and last month's reading was revised down (0.5% instead of 0.6%). Yes, we went from Chair Powell discussing disinflation risks at the first FOMC meeting of the year to hearing about more inflation concerns. However, I remain in the camp that most of the inflationary pressures have subsided and the Fed has already gone too far.

Inflation data should help the bond market.

Jobs

The most consistent economic data of any type has been the jobs data. While other data has hinted at slowdowns (and then at rebounds), the jobs data has been quite steady.

Lost in the shuffle in March (largely because of the focus on Silicon Valley Bank and broader banking fears), **we seem to have forgotten that wage pressure looked like it was declining in the February data**.

Last month, rather than a simple instant reaction to NFP, we had to publish NFP, Debt Ceiling & Bank FUD because even on the day that it was published, the jobs data was taking a back seat.

Total jobs (I'm looking for disappointment) and wage pressures (I expect continued improvement) will move markets and the two pieces of data combined will determine the market's direction. There is a wide range of possible outcomes. I'm in the camp that jobs growth will be small enough that it will ignite recession fears, but we could also easily see a "goldilocks" type of print. Fortunately, we will have more clarity well before Friday as JOLTs and ADP both come out this week.

The Fed

The Fed is almost done hiking. They shouldn't have hiked last month given my view on inflation (already coming down) and concerns about the lag effects of previous hikes. They clearly pushed some things/entities to the breaking point.

I expect that the Fed will have to continue to message that they will not cut rates anytime soon. I would have agreed with that message earlier in the year, but as they continue to hike, they seem to be creating conditions that could cause them to reverse course against their messaging.

Stocks as a "Long-Duration" Asset Redux?

I can see why risky assets are getting a bid. The investment thesis that stocks are long-duration assets that will do incredibly well as the Fed finishes their hiking cycle is simple/compelling and has recent history on its side. Who doesn't want to see some of these companies return to their former glory?

However, I just don't think that conditions are right for that sort of spike:

- 4% rates are far different than rates at 0%.
- Gobs and gobs of free money are not getting paid to citizens/companies now (unlike during COVID).
- While the Fed balance sheet grew again (as they had to lend money to banks), the large-scale asset purchases that were constantly taking investible assets out of the market have been replaced by a plan to slowly reduce the balance sheet.
- Growth had taken on a life of its own. The "bigger" the growth story, the better. Markets might be a little more jaded this time around.

Bottom Line

Small positive bias for bonds. The data should continue to support the bond market, though jobs remain a wildcard on that front.

Neutral to slightly bearish on credit spreads. Credit spreads do tend to be tied to the cost of funds for banks. At the moment, I see that trending higher. Similarly, we could also see some heavy issuance as

companies ramp up bond sales while rates are low, spreads are decent, and the debt ceiling debate (and summer) are both approaching quickly.

Slightly cautious to medium bearish on equities. I could decide that I was wrong to be somewhat cautious on equities last week and get on the "breaking to new levels" bandwagon. That view has a lot of support. Or, however, I could fade the move as discussed Thursday on Bloomberg TV and be more conservative (growing a short position in equities here). The VIX spiking was an indication that real hedges were being put on and this wasn't just investors popping in and out of 0DTE options (which don't count in VIX calculations) or a result of quarter-end buying.

So, what wild and crazy unexpected thing will happen in Q2 2023? If you told me that I would use "banks and crisis" in a sentence during Q1 on January 1st, I probably would have laughed, and yet, that's what happened.

Good luck and if you missed our latest Around the World, I highly recommend catching up on it because the **geopolitical issues and risks are not going away.**

Disclaimer

This document and its contents are confidential to the person(s) to whom it is delivered and should not be copied or distributed, in whole or in part, or its contents disclosed by such person(s) to any other person. Any party receiving and/or reviewing this material, in consideration therefore, agrees not to circumvent the business proposals explicitly or implicitly contained herein in any manner, directly or indirectly. Further, any recipient hereof agrees to maintain all information received in the strictest confidence and shall not disclose to any third parties any information material to the opportunity contained herein and, upon review hereof, agrees that any unauthorized disclosure by any party will result in irreparable damage for which monetary damages would be difficult or impossible to accurately determine. Recipients recognize, and hereby agree, that the proprietary information disclosed herein represents confidential and valuable proprietary information and, therefore, will not, without express prior written consent, disclose such information to any person, company, entity or other third party, unless so doing would contravene governing law or regulations.

This document is an outline of matters for discussion only. This document does not constitute and should not be interpreted as advice, including legal, tax or accounting advice. This presentation includes statements that represent opinions, estimates and forecasts, which may not be realized. We believe the information provided herein is reliable, as of the date hereof, but do not warrant accuracy or completeness. In preparing these materials, we have relied upon and assumed, without independent verification, the accuracy and completeness of all information available from public sources.

Nothing in this document contains a commitment from Academy to underwrite, subscribe or agent any securities or transaction; to invest in any way in any transaction or to advise related thereto or as described herein. Nothing herein imposes any obligation on Academy.

Academy is a member of FINRA, SIPC and MSRB. Academy is a Certified Disabled Veteran Business Enterprise and Minority Business Enterprise and is a Service Disabled Veteran Owned Small Business as per the US SBA. Investment Banking transactions may be executed through affiliates or other broker dealers, either under industry standard agreements or by the registration of certain principals.