Moving Beyond Banks

Testimony on the hill yesterday turned financials (XLF and KRE) from positive to negative and dragged broader risk markets down with them. Overnight, financials and broader risk markets performed well (CDS indices in Europe are particularly strong).

The good news is that the overdone fear of depositor losses seems to be behind us (even after D.C. did little to help on that front yesterday).

I have some ongoing concerns about deposits from an overall yield standpoint (I Know What You Did Last Winter) and if I'm correct, these concerns will play out in slow motion.

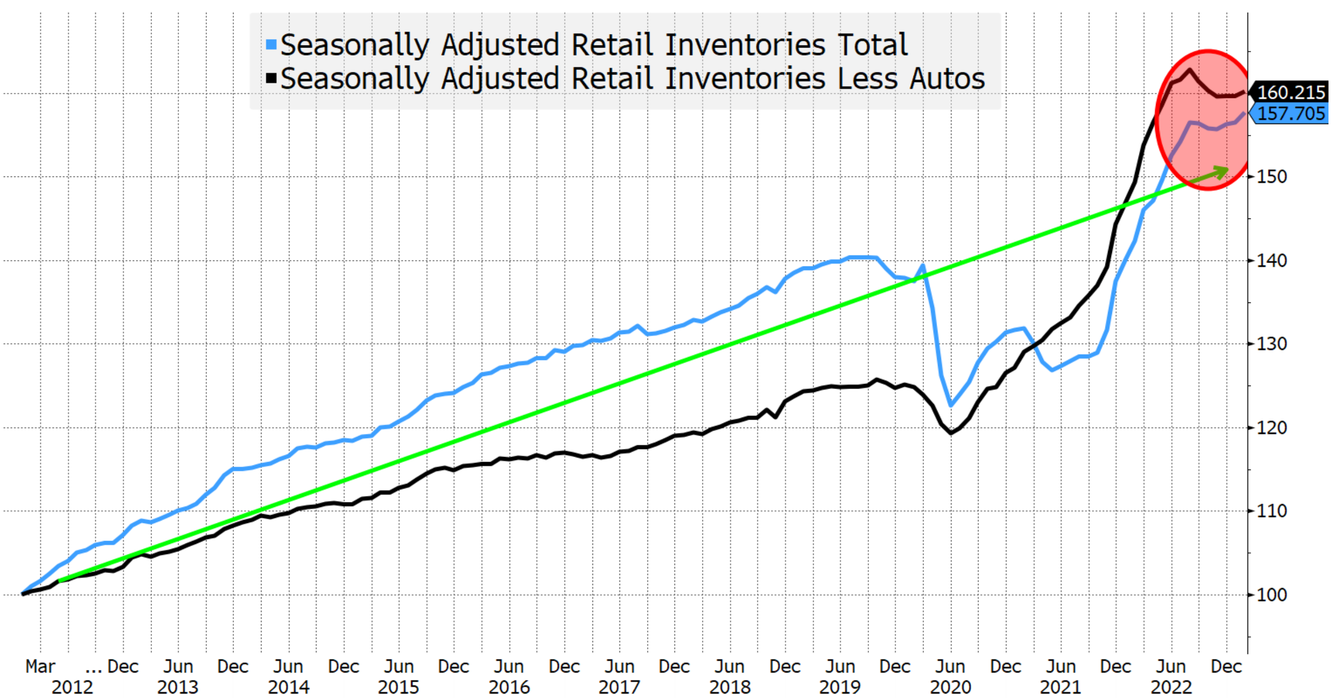
The overall question of "**unrealized bond market losses**" (we can include loans and private debt for these purposes) in the financial system hasn't gone away, but many are wondering if it is already priced in. I expect that the "unrealized bond market losses" will play out in three ways:

- As more **in-depth research on specific balance sheets** is done (probably by distressed analysts, rather than by traditional analysts), there is a risk that some entities will be flagged as being overexposed to obvious risks.
- If questions arise about **deposit stability (or cost of funds)**, then these unrealized bond market losses will weigh on the entire sector again. However, I would expect that the impact would be more correlated with institutions identified as having some potential losses of a material size.
- Pull to par and time will help (as does a strong economy) and there will be a "healing" process.

The final issue (one that became painfully obvious yesterday) is that the industry has to brace for another round of regulatory scrutiny brought on by a few particularly egregious situations.

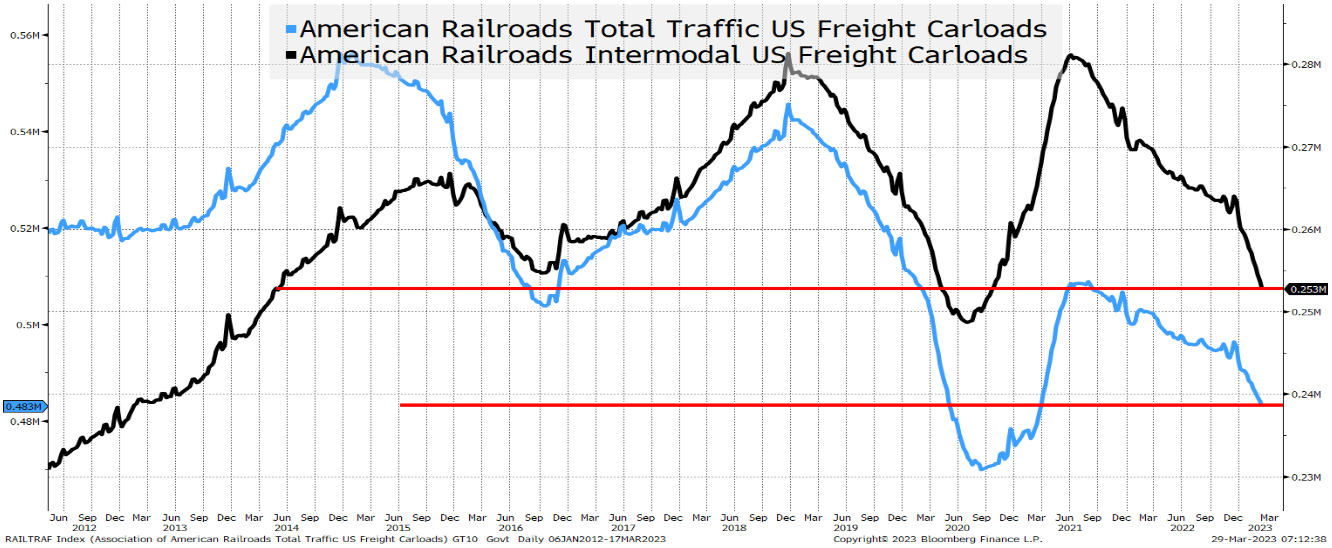
Inventories, Shipments, and Delinquencies

With so many potential things to look at, today we will just revisit a few that have influenced our outlook for the past year or so.



Inventories remain elevated and even after some progress seem to be ticking higher again. This can be partly explained by supply chain resolution (but more likely by consumer fatigue). We compare this to total retail inventories (less autos) just to make sure that the automobile industry, which experienced more than its fair share of supply chain issues, isn't impacting the data disproportionately (it doesn't seem to be).

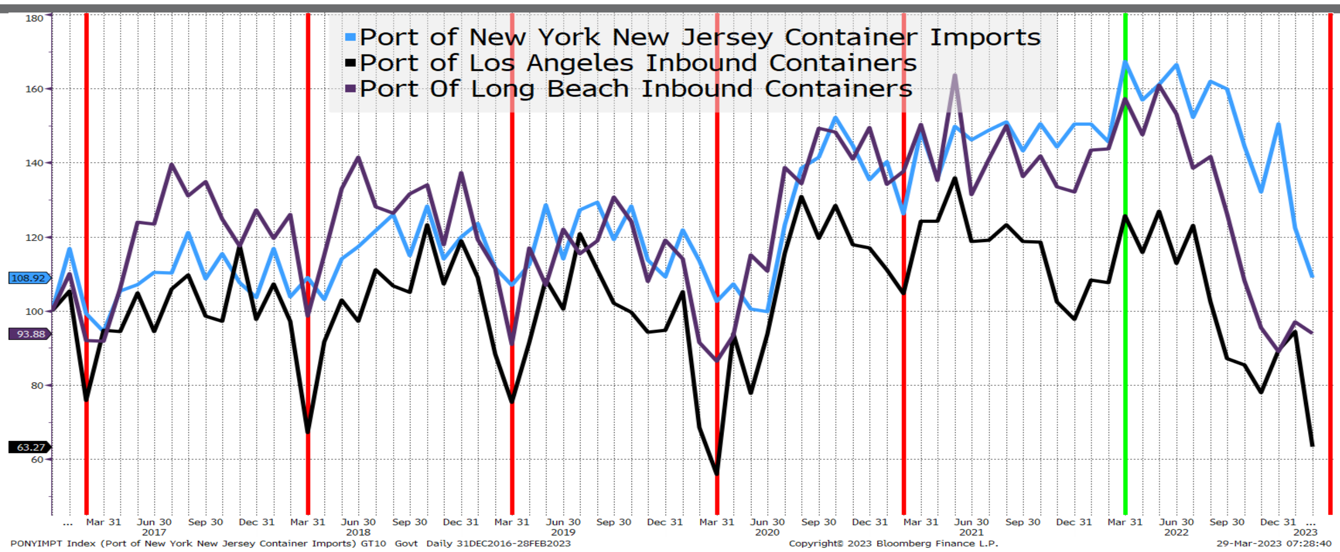
A quick look at credit card debt, credit card delinquencies, and auto loan delinquencies shows a deteriorating trend (higher debt/higher delinquency frequency). However, in most cases, this is still below pre-Covid historical averages. Nothing to be overly concerned about today, but **the trend is heading in the wrong direction for those who are arguing that we can never bet against the American consumer.**



We used 50-day moving averages here because the weekly data is highly volatile and has some serious seasonality (i.e., ramp up pre-holidays, slow down during holidays). Some of what we are catching in the data may be typical seasonal effects (though it looks worse than that). It is possible that the tragic derailment in East Palestine is affecting the data (but I do not have that level of granularity).

For me, it does fit into the "we overordered" and "we have too much inventory" so "we are taking our foot off the gas" narrative that I am using for **goods inflation** and the potential economic impact.

I could look at the Baltic Dry Index (bounced, but remains in a downtrend). However, I will try to figure out what to do with this messy ports' data.



For some reason I couldn't get the moving average data to work. In 2017 the lows were in February, but for the following years, the lows were in March. So, there is some seasonality to them, however:

- That seasonality did not exist last year when the ports remained busy throughout the year (makes me wonder about the "China is closed vs China is re-opening" narrative).
- If historical data is correct, we should see worse data in March. The chart is now getting to be lower than historical levels (with a big drop-off from the average of the past 2 years).

Given how messy this first cut of data is, maybe it isn't relevant. However, maybe it is telling us that companies are trying to fix the inventory "glut" (my word) by ordering less.

Bottom Line

I remain in a cautious "risk-off" stance. Positioning doesn't need to be all doom and gloom (trying to time some moves higher and lower is not a bad idea), but I'm erring on the side of caution. Small short or small underweight positions (as laid out in Sunday's report) make sense.

Also, as per Sunday's "Last Winter" report, there seems to be more obvious "event risk" to the downside rather than the upside. Yes, that means that the market is hedging and preparing for this, but if any of these events materialize (debt ceiling, China selling weapons to Russia, etc.) they will still drag markets lower.

The overdone fears of bank deposit safety should be behind us, but now we can all examine the economy again (not liking what I see) and start prepping for earnings which are just around the corner!

Disclaimer