NFP, Debt Ceiling, & Bank FUD

On Thursday, markets were reacting nicely to a small increase in jobless claims and then got dragged down by two big things – a renewed focus on the debt ceiling and a particular bank (named after the geographic area that it focuses on). Today, in true T-Report fashion, **we will work from least to most important!**

NFP

Today's jobs report should be good for bonds (and ultimately for markets).

The headline number was strong (311k versus expectations of 225k and revisions were "only" down 34k).

The factors that will help the Fed lean towards 25 bps are:

- Average hourly earnings came in at 0.2%, which is good and consistent with other data highlighting that **wage growth is slowing**.
- **Weekly hours worked dropped** from 34.7 (revised down to 34.6) to 34.5. Hours worked is often a leading signal about future employment needs, so that number moderating reduces the need to hike aggressively.
- The unemployment rate popped to 3.6% from 3.4% partly due to a weaker Household Report, an **uptick in the labor participation rate** (really good news as it alleviates labor market pressure without forcing job losses), and probably some rounding.

Normally, on NFP, we should be "done and dusted" for the day after this report and just watch how markets react, but there is more going on.

Debt Ceiling

President Biden released his "budget talking points." Although virtually everyone instantaneously agreed that it is "dead on arrival," it still impacted markets. The starting point isn't a compromise or "reaching across the aisle." It is setting up camp as far away from the other side as possible and digging in while waiting for the battle to begin. I almost never look at sovereign CDS (at least not for major countries), but the U.S. CDS spread is widening (though it is still tiny). I presume (and I need to re-read the ISDA language) that there is some sort of "cheapest to deliver" trade around a technical default.

In any case, while we thought that the debt ceiling debate would be more disruptive (by far) compared to previous episodes, I thought that we had some more time. We might not.

Bank FUD

To make it easy on compliance, I won't mention any institutions by name today (that will be in the weekend report), but off-hand I think that recent events are more isolated and not indicative of a broader existential problem.

Bank Existential Problem

- I see nothing that is a threat to the broader banking system on an existential level.

Problems for all Banks

- **Having to raise deposit rates** because investors are "suddenly" fixated on yields (we felt compelled to write about 2-year yields). That is an earnings issue, but by no means an existential threat.

- **Commercial Real Estate.** One area that I cannot help but keep an eye on as we measure success in work from office (compared to work from home) is the commercial real estate market. I think there could be some issues – but only in certain pockets and regions.

Unique or "Self-Made" Problems

- **A highly concentrated and correlated depositor base**. When the source of money comes from very similar clients, you are very susceptible if those clients have problems. Not just from the individuals, but also from the companies. **Cash flow burn (without replenishment) has hit the "disruptive" community hard** – a long running T-Report theme.
- **When your borrowers look like your depositors**. I haven't looked at the loans but allegedly there was overlap between who was being lent to and who was depositing money. Nothing goes pear-shaped more quickly than lending to entities which have to drain their deposits to zero just to stay afloat and then need to restructure their loans. **I cannot say this has happened, but a lot of things are pointing in that direction.**
- What likely started as a "normal course of business" reduction in the deposit base likely put pressure on the bank in question and started the cycle of liquidation, bad stories, etc. **Only then did it morph into people (in general) deciding that there might be better places to stash their cash**.

Pure FUD

- **Many in the crypto community (with 100s of thousands of followers) seem to be feeding disinformation.**
    - I've seen well-read reports discussing **banks leveraging 10-year Treasuries** against their deposit base. I think that would be extremely difficult to do under current regulations and goes against what I've seen from most banks (taking credit risk while carefully managing interest rate risk).
    - **Little to no discussion about bank stress tests**. I didn't expect these tests to be as well designed or as thorough as they became. No, you cannot rely on them completely, but too little is being discussed about this.
    - The crypto community would like this to be a "banking" story because that would push people into crypto. However, it looks like it is just the usual story about an individual institution or two that got in over its skis. Almost every year, some banks get into trouble (and some eventually default), but the market usually just yawns. The current situation is attracting far more attention than usual and I'm not certain why. There is of course an entire cottage industry out there predicting the next financial crisis and they have something new to sink their teeth into. More often than not, it has been the "imminent" default of BBB bonds that has attracted their attention.

Bottom Line

On a standalone basis NFP should help stocks and bonds. The debt ceiling will hurt stocks, but that can move to the background.

The hit to banks seems overdone and I'm looking at the case to overweight banks (in stocks and credit).

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.