The Longo Group

Independent Financial Firm

Week Ahead

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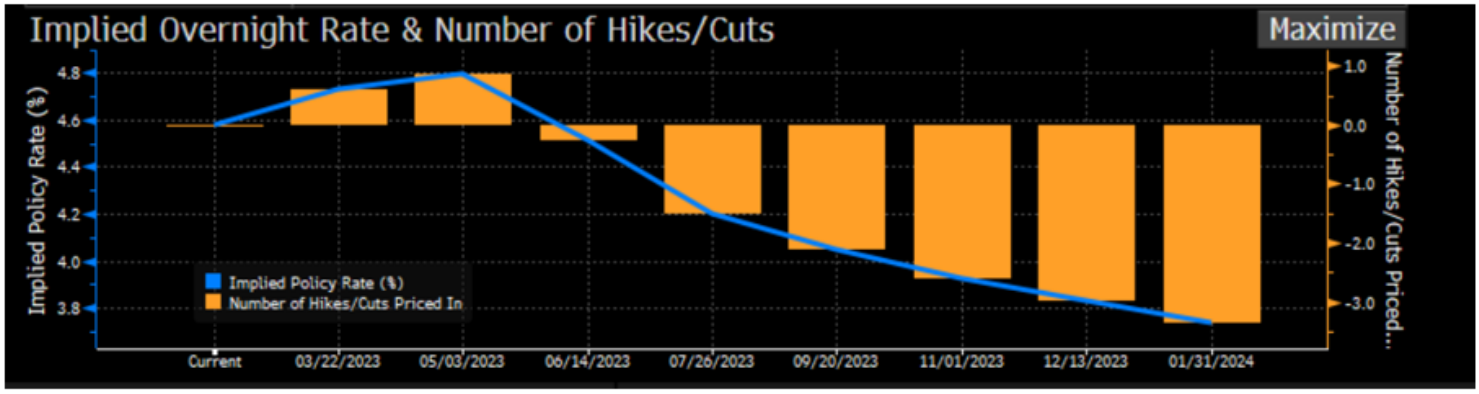
Week of
March 20, 2023

Market Volatility Stays Until Bank Crisis Is Fully Resolved

One would not have expected the equity markets to actually rally amid a U.S. banking crisis – but because stocks are so oversold on a short-term basis and measures have been taken to help fix this crisis, a rally did indeed begin last week.

As long as the banking crisis sparked by the SVB collapse continues and the Federal Reserve continues to raise interest rates, the markets will remain volatile. This Wednesday (3/22), all eyes will be on the rate decision by the Federal Open Market Committee (FOMC) as well as their comments on the future direction of interest rates. As of this writing, expectations in the market are split between a 25-basis point hike and a pause. Looking ahead, the market is pricing in rate cuts of up to 100 basis points (see chart below). We have been here before, where the market expects future rate cuts only to have the Fed squash those expectations. This is a risk to the volatility of the markets.

Expected Rate Policy and Number of Rate Hikes



Source: Bloomberg, March 17, 2023

Historic Short Squeeze in 2-Year Treasuries and Flight to Safety – Rates Plummet

It's a historic time for 2-year Treasury yields as there has only been four times in history when 2's have moved more than 50 basis points in a day – once in 1987 and three times (!) this past week alone. Rates have moved from a peak of 5.08% to a low of 3.7%, driven in part by hedge funds being caught short (and needing to cover) plus a clear flight to quality. So, right now, "volatility" is a polite understatement. And rates could remain volatile until the banking crisis is resolved – and we get through the uncertainty of the 3/22 Fed meeting.

Near-term 2-year Treasury yields are very oversold and can bounce. The market still needs to digest the regulators actions around SVP, along with the capital infusion from various large banks to First Republic Capital (FRC); what does it all mean for the banks in general and the economy at large? Meanwhile, a resolution for Credit Suisse (CS) was announced over the weekend with UBS Group AG agreeing to buy CS with a deal brokered by the Swiss government to help restore confidence.

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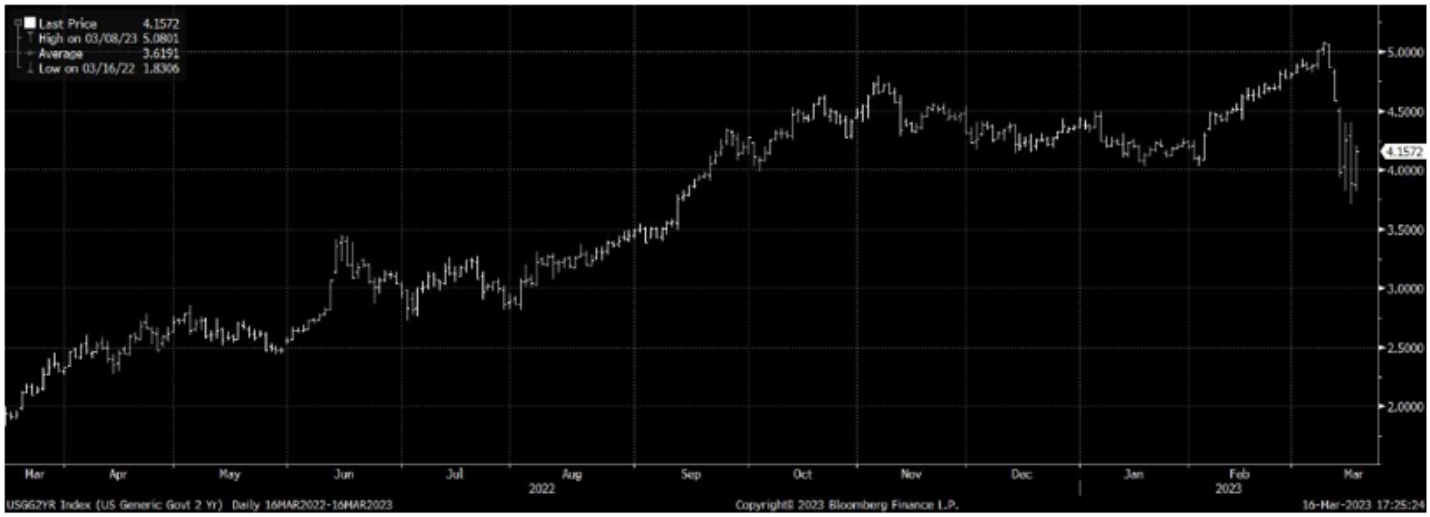
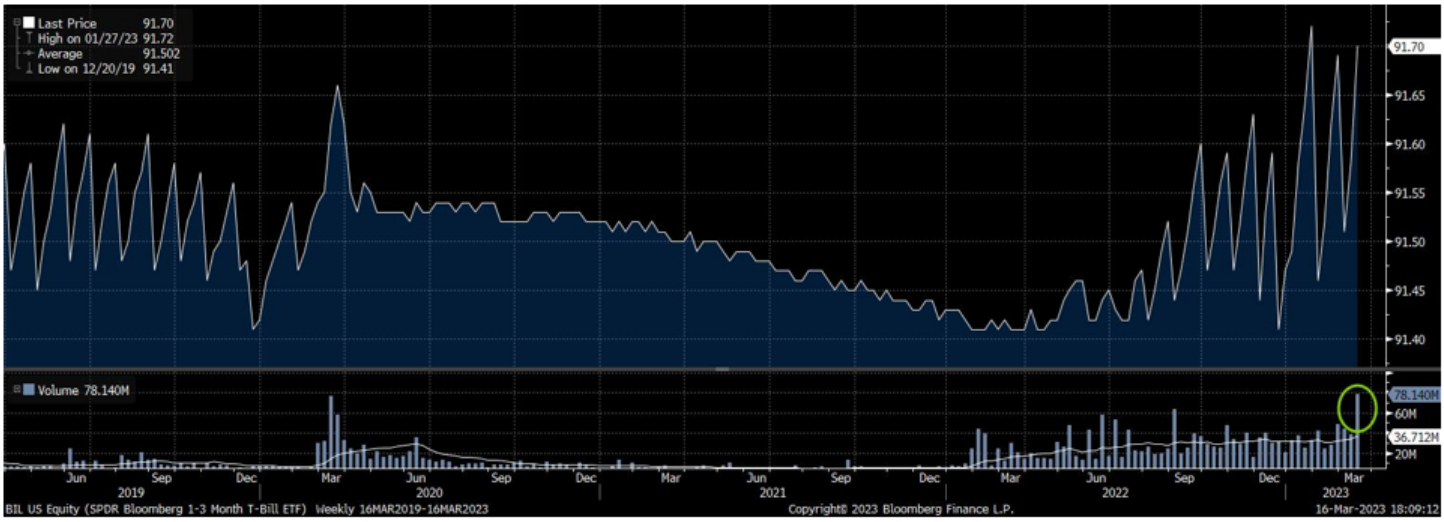
2-Year Treasury Yields



Source: Bloomberg March 16, 2023

Flight to Safety in Treasury Bills on Huge Volume

SPDR Bloomberg 1-3 Month T-Bill ETF (BIL)



Source: Bloomberg March 16, 2023

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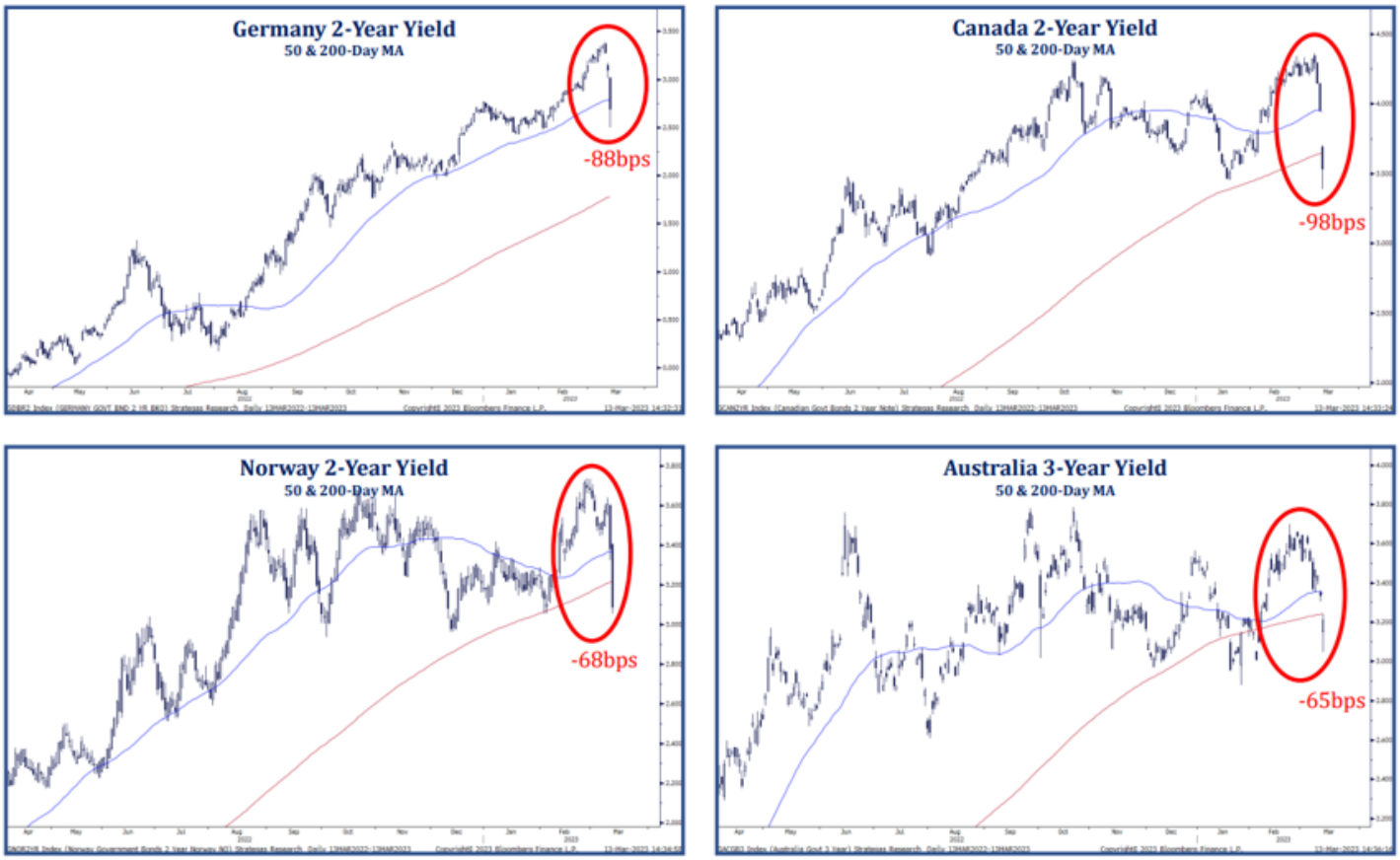
Yields Collapse Globally



Source: Strategas, March 13, 2023

While Stocks Rally on Bank Bailout

The S&P 500 held support at the 3800 level (which sounds amazing given that two banks failed in short order during the past 10 days). The support range is 3800-3700. If 3700 is broken, the risk is a test and even break of the October low. As mentioned above, we believe the market is rallying because it is very oversold short term. As long as the regulators are managing the banking crisis and investor confidence is not broken, the S&P 500 support range could hold. Last night (3/19), it was announced that the Federal Reserve and five other central banks (Bank of Canada, Bank of England, Bank of Japan, the European Central Bank and the Swiss National Bank) would boost liquidity in the U.S. dollar swap market to ease growing stress in the global financial market.

Despite these moves, should market confidence break or if another U.S. bank becomes a risk, then either a test or a breach of the October low can happen. For the S&P 500, the next support after 3700 is near 3500.

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S&P 500 Index

Source: Bloomberg March 16, 2023

Nasdaq 100 Rallies More as Technology Stocks Rally Sharply

As this banking crisis has developed, there has been a rotation occurring where the cycle sectors that had been performing well (such as Industrials, Materials, and Energy) are now under pressure and the recently beaten down Technology sector is now rallying. We sense the market is beginning to price in a recession and is moving more defensively or to where stocks prices have corrected and valuations are now perceived to be better. The Nasdaq 100 is technology heavy with MSFT, AAPL, AMZN, NVDA, GOOGL and META making up 47% of the index. We still have concerns about this area of the market that is very concentrated.

Nasdaq 100 Index

Source: Bloomberg March 16, 2023

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Growth Performing With Technology Rally

As Technology stocks (Growth) rally and as Bank stocks (Value) fall, Growth begins to outperform Value. As long as Bank stocks remain under pressure, Value is likely to underperform. Many Bank stocks are trading below book value, which historically is a good buying opportunity. But it may take time to bring back confidence to the sector, so they look to underperform for a period of time. This points to Growth outperforming in the coming weeks and months.

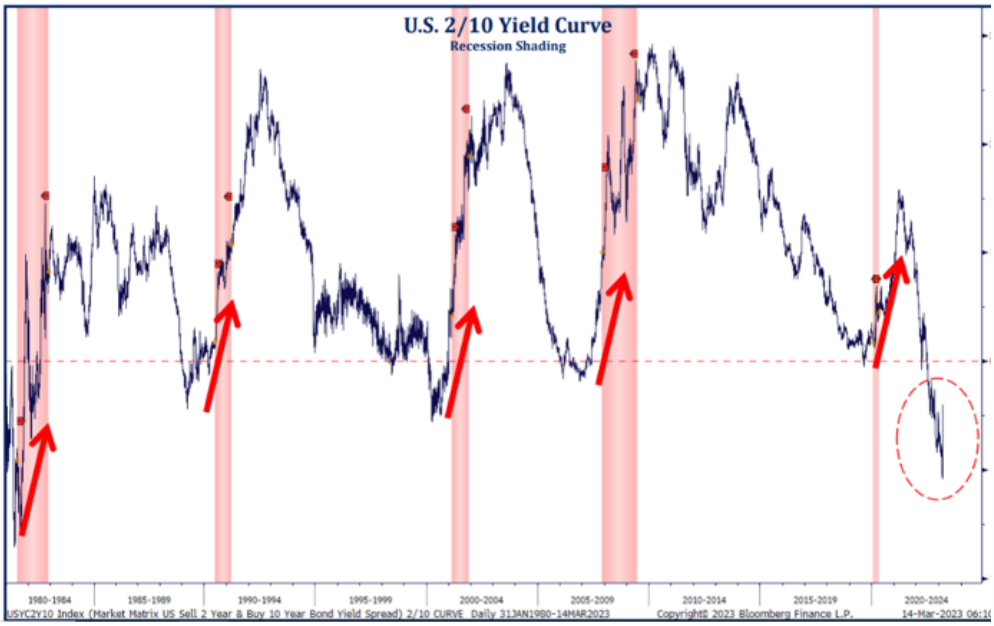
Growth Versus Value

Source: Stockcharts.com, March 17, 2023

Bull Steepening Signals A Pending Recession

Strategas, a top ranked macro firm, is pointing out that, historically, after an inversion of the yield curve and a bull market begins to steepen, it signals that we are close to a recession. Based on how investors are reallocating to Treasuries (especially short term), and how they're reducing their investment in cyclical sectors, we would believe a recession is getting priced into the markets.

Treasury Yield Curve 2/10's



Source: Strategas, March 14, 2023

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Gold Rallying and Outperforming

Historically, gold is an asset that has protected portfolios during downturns and market crises – and it is doing it again. Gold is up 8% and is outperforming the S&P 500 (which is up 2%) with a relative breakout suggesting gold will continue to outperform the market. If gold breaks to a new all-time high and can hold this level, it would be a very significant move for the metal.

Gold and Gold Relative to the S&P 500

Source: StockCharts.com, March 17, 2023

Crude Oil Breaks Down Risk to $60-$50

Crude oil has broken technical supports, risking the commodity to fall into the range of $60-$50. This has been putting pressure on the Energy sector. The collapse in oil prices is an additional signal that the market is pricing in a recession.

Light Crude Oil

Source: StockCharts.com, March 17, 2023

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Dr. Copper Is Also Falling

Copper has traditionally been used as a barometer of the strength or weakness of the economy. Copper is falling, albeit not as sharply as oil. Nonetheless, the message is a weaker economy lies ahead.

Copper

Source: StockCharts.com, March 17, 2023

Bitcoin Is Attempting A Breakout and Outperforming

Interestingly, Bitcoin (BTC) is attempting a breakout from a base formation, and if this holds, it will suggest a move higher. It also suggests that BTC is being considered a safe haven asset by some, which would be a new characteristic. BTC has a "halving" every four years and in 2024 this will occur again. Historically, BTC rallies prior to the halving, so this could also be a reason for the token to be moving.

What Happens When Bitcoin Halves?

The term "halving" as it relates to Bitcoin has to do with how many Bitcoin tokens are found in a newly created block. Back in 2009, when Bitcoin launched, each block contained 50 BTC, but this amount was set to be reduced by 50% roughly every four years. On April 8, 2024, at 06:12:05 PM UTC the Bitcoin block reward is scheduled to drop from 6.25 Bitcoin per block to 3.125 Bitcoin per block. There is a limit to the amount of Bitcoin to be created. Once the 21 million supply limit is reached, no more Bitcoin will be released creating a scarcity value.

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Bitcoin and Bitcoin Relative to the S&P 500

Source: StockCharts.com, March 17, 2023

March Madness No One Wants

This is the week that the Fed's next move will clarify its priorities: inflation or banks.

The banking crisis and the fear of a contagion among regional banks have been a significant distraction for the Fed, which had been so singularly focused on its war on inflation. Prior to the SVB collapse, expectations were high for a 50 bps rate hike on March 22, due to the continued strength of the jobs market. But SVB's collapse, then Signature Bank's takeover by the FDIC, and even rising concerns over First Republic and its plummet in stock price changed everything. It's possible the Fed will pause its rate hikes for now – but it's more likely we'll see a 25 bps increase – because inflation is proving to be too darn sticky.

Whatever Fed Chair Powell announces on Wednesday, expect volatility to stay with us until the banking crisis is put to bed – and, importantly, until consumers indicate their confidence in their bank deposits again.

Calendar

Mon.

Earnings: **GitLab, Ko**diak Sciences

Tue.

6:00 a.m. NFIB Optimism index
8:30 a.m. Consumer price index, Real hourly earnings
Earnings: Caleres, Guess?, IHS Holding, Lennar, SentinelOne, StoneCo

Wed.

8:30 a.m. Retail sales, Producer price index, Empire State manufacturing
10:00 a.m. Homebuilders' survey
Earnings: Adobe, Array Technologies, Ebix, Five Below, Franco-Nevada, Oatly Group, Proterra, The Children's Place, UiPath, ZTO Express

Thu.

8:30 a.m. Initial jobless claims, Import price index, Housing starts, Building permits, Philadelphia Fed manufacturing
Earnings: Academy Sports + Outdoors, Designer Brands, Dollar General, Fedex, G-III Apparel, Hello Group, Jabil, Signet Jewelers, Titan Machinery, Traeger, Williams-Sonoma, Yamana Gold

Fri.

9:15 a.m. Industrial production, Capacity utilization
10:00 a.m. Algonquin Power & Utilities, Ballard Power

Source: MarketWatch/Kiplinger