

Keys to the market

What happened last week

March 24, 2023

With last week bringing another bank failure, investors continued to fret over banking sector stress. In a deal facilitated by the Swiss National Bank, UBS took over Credit Suisse last Sunday, with ample liquidity backing and loss guarantees from the Swiss authorities. The financial markets welcomed the news on Monday, and stock prices recovered slightly. In what some would be termed a dovish hike, the U.S. Federal Reserve raised its policy rate by 25 basis points on Wednesday, as expected. The Fed noted that the tightening of financial conditions in recent weeks is equivalent to further rate hikes. This news appeased the markets only briefly, as further areas of stress materialized, such as regional banks' exposure to commercial real estate and Deutsche Bank's sizeable derivatives book. If banks tighten lending conditions further, they could precipitate the forecast slowdown in economic growth. As volatility rises, the markets are looking for reasons to be spooked.

U.S.: Financial Conditions Index

Bloomberg, as at 3/24/2023



Bond market

Yes, we saw a 25-basis-point hike by the Fed and further easing of inflation in Canada, with the CPI declining to 5.2%, but what continued to affect bond market sentiment the most during the week was persistent concern about the global banking system and the associated flight to quality. The 10-year Treasury yield fell 25 basis points from its weekly peak to close just above 3.3%, while the 2-year yield plummeted 45 basis points to hover around 3.7%, neither of which is anywhere near the Fed's 5.0% policy rate. Regardless of banking fears, we still see the Fed raising rates by another 25 basis points at its next meeting in May, barring complete market chaos in the meantime. As expected, risk-off sentiment moved IG and HY spreads higher by week's end, despite some tightening early on.

Highlights

- The Swiss National Bank forced a merger of UBS and Credit Suisse to stabilize sentiment over the global banking sector, albeit with limited success.
- Fears of a spillover into U.S. regional banks gripped the financial markets.
- The U.S. Fed may have signaled the end of the hiking cycle, given that tighter lending conditions will increase the probability of a contraction.

On our radar

- Canada: January GDP
- United States: March Manufacturing PMI and Consumer Confidence

Stock market

Yet another roller coaster of a week in the stock market started with a forced marriage between two very reluctant parties. The union of UBS and Credit Suisse was aimed at allaying investors' concerns about the global banking situation, but their focus promptly switched to the FOMC meeting, which probably marked the end of the hiking cycle. Furthermore, the Fed's projection of 4.5% unemployment by year-end is commensurate with a recession, which compounded the prevailing negative sentiment.

In the days to come, the focus will be on the spillover effect of potential further regional bank failures. Small and medium-sized banks play an important role in the U.S. economy, and tighter lending conditions put pressure on economic growth. We expect a continued rotation out of the cyclical sectors (consumer discretionary, autos, real estate, etc.) into the more defensive ones (consumer staples, health care and utilities), as market participants assess the combined economic impact of the interest rate hike and a tighter credit environment.

Markets

(Total Return, in \$CAD)

| As of March 23, 2023 | WTD % | MTD% | YTD% | 1Y% | 3Y% | 5Y% |
|-----------------------------------|-------|-------|--------|--------|-------|-------|
| Equities | | | | | | |
| S&P 500 | 0.15 | -0.07 | 4.11 | -1.94 | 20.28 | 12.08 |
| S&P/TSX | 0.39 | -3.53 | 1.08 | -8.39 | 23.80 | 8.30 |
| NASDAQ | 0.98 | 6.05 | 17.30 | -4.16 | 19.51 | 15.73 |
| MSCI ACWI | 0.86 | -0.18 | 4.82 | -0.98 | 18.31 | 8.87 |
| MSCI EAFE | 2.62 | 0.53 | 6.91 | 5.92 | 15.26 | 4.51 |
| MSCI EM | 2.09 | 1.97 | 3.40 | -3.62 | 9.58 | 0.37 |
| Commodities (USD) | | | | | | |
| Gold | 0.21 | 9.11 | 9.29 | 2.55 | 8.67 | 8.15 |
| CRB | 0.53 | -0.54 | -1.66 | -13.80 | 13.55 | 4.44 |
| WTI | 4.82 | -9.20 | -12.83 | -39.13 | 44.14 | 1.21 |
| Fixed Income | | | | | | |
| FTSE TMX Canada Universe | 0.14 | 3.17 | 4.24 | -0.90 | -1.36 | 1.19 |
| FTSE TMX Canada Long | -0.39 | 3.97 | 6.11 | -4.63 | -4.22 | 0.24 |
| FTSE TMX Canada Corporate Overall | 0.14 | 2.17 | 3.64 | 0.00 | 1.14 | 1.85 |
| Currencies | | | | | | |
| DXY | -1.13 | -2.23 | -0.96 | 3.96 | 0.01 | 2.77 |
| USDCAD | -0.12 | 0.50 | 1.19 | 9.18 | -1.82 | 1.24 |
| USDEUR | -1.48 | -2.36 | -1.16 | 1.62 | -0.33 | 2.67 |
| USDJPY | -0.76 | -3.91 | -0.21 | 8.01 | 5.56 | 4.55 |
| USDGBP | -0.93 | -2.15 | -1.66 | 7.49 | -2.05 | 2.84 |

Source: iA Investment Management, Bloomberg

| | CA | US |
|-----------------------|------|------|
| Bond yields | | |
| 2Y | 3.44 | 3.83 |
| 5Y | 2.77 | 3.44 |
| 10Y | 2.75 | 3.43 |
| 30Y | 2.93 | 3.70 |
| Credit spreads | | |
| IG corporate bonds | 175 | 152 |
| HY bonds | 408 | 510 |

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ROOTED IN HISTORY, INNOVATING FOR THE FUTURE.

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