Email Body 3/20/2023

**What Will the Federal Reserve Do Now?**

I trust you are all enjoying this first day of spring. Here in San Diego, we are still getting what I believe to be unseasonably cold weather. It is not so much that we are not used to cold weather this time of year. Its that we typically get breaks from it with lots of intermittent warm sunny days. This year, not so much. Maybe with it being officially spring starting today, our luck will change.

Well, as I am sure you all are aware, something finally broke in response to the Federal Reserves’ rate raising regime over the past year. Silicon Valley Bank (SVB) and Signature Bank were taken over by regulators in response to the bank’s inability to meet customer withdrawal demands. The reasons customers were requesting withdrawals varied, but mainly they related to concerns with the banks announcing significant losses on the sale of Treasury and mortgage-backed securities held as reserves.

After the 2008-2009 financial crisis regulators began requiring banks, particularly regional and small banks to hold a higher percentage of their required reserves in treasury and other Federally backed debt securities. SVB followed through on this requirement particularly with the influx of cash it got early on in the Covid pandemic. The cash received was quickly invested in treasuries and other mortgage-backed bonds paying less than two percent. The Federal Reserve began raising interest rates in 2022 which negatively effects the current value of existing bonds. SVB has a very narrow depositor base consisting primarily of tech start-ups, tech entrepreneurs and other associated wealthy individuals and venture capitalists. The result was that ninety-five percent (95%) of SVB’s deposits were above the FDIC guarantee limit of $250,000. Withdrawals began early in 2022 as the tech sector fell on tough times and firms needed to access their capital as venture capital funding dried up. The roof fell in when SVB had to sell off a portion of their reserves to fund withdrawals and actually book a significant loss.

The Federal Reserve and associated regulators from the Office of the Comptroller of the Currency and the Consumer Financial Protection Bureau did the right thing and guaranteed deposits to 100% of their value to prevent a nationwide contagion of bank runs on regional and small banks. The larger banks are in very good shape because they are very well capitalized, have a broader array of revenue generating business activities and a much more diverse depositor base with much lower percentages of deposits in excess of FDIC limits. Assessment of what happened at SVB, Signature bank, First Republic and Credit Suisse continues, but it looks like Federal Reserve and regulator actions have been successful at calming emotions.

The question most are asking at this time is what the Federal Reserve will do at this week’s meeting. One week ago, the smart money was betting that the Federal Reserve was going to do a 0.50% rate hike. Then last week, inflation statistics came in showing minor declines indicating that inflation is receding, but very, very slowly. Now the expectation is a 0.25% rate hike. The hope is that the statement the Federal Reserve releases after this week’s meeting will indicate some sort of softening of future rate hike expectations with a stopping point somewhere between 5.25% and 5.75%. Currently, the Federal Reserve is targeting 4.50%-4.75%.

So, what to expect for the markets in the near future? Obviously, anything can happen to roil the markets. Risks include the Federal Reserve raising interest rates higher than expected, economic recession on a broader scale, or the Ukraine conflict going sour. However, I believe the most likely scenario is for the market to continue to trade in a range over the next few months, though not likely to go below last October’s low point.

The effects of the interest rate hikes over the last year are being felt in the economy. Spending is beginning to decline, various sectors are increasing layoffs, manufacturing is contracting, real estate is slowing, inflation is declining ever so slowly, and with the SVB failure, we are likely near the end of the Federal Reserve rate hike cycle. As these trends become more evident over the next few months, the stock market will anticipate economic recovery and revert to its upward bias. I cannot tell you the exact timing of this, just that it will happen as it has always do so in the past.

Attached to this email is a note penned by Brad McMillan, Commonwealth’s Chief Financial Officer. In it he discusses the causes of the recent bank failures, how the Federal Reserve is addressing it and what impacts you can expect in the months ahead. It is an interesting take.

Make sure that funds you know you will need in the short-term are safe to relatively safe from volatility and that your long-term oriented investments are well diversified and subject to risk and volatility levels you are able to be comfortable with. If you have any questions or concerns about these things, please call me to discuss them further.

I am always available to you via phone, zoom conference or in person. I look forward to talking with you over the next few weeks. If you have any questions or if we can be of any help, please do not hesitate to contact Linda or me.

*Certain sections of this commentary contain forward-looking statements that are based on our reasonable expectations, estimates, projections, and assumptions. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. Past performance is not indicative of future results.*

Christopher L. Phelps, CPA/PFS, CFP®, AIF®

Principal

Phone (858) 485-1919   Fax (858) 487-0355   chrisp@financiallifeconcepts.com

 

16935 W. Bernardo Drive, Ste. 228, San Diego, CA 92127  [www.financiallifeconcepts.com](file:///C%3A%5CUsers%5Cchrisp_mhbfc.com%5CDesktop%5CRestore%5CDocs%5CMass%20Client%20E-Mails%5Cwww.financiallifeconcepts.com)