Weekly Market Insights

March 27, 2023

An Odd Market Indeed!

Financial Markets

Equity markets are reacting to every piece of news that comes out and with very little consistency. This past week was an excellent example given the constant news flow regarding ongoing issues in the banking sector and the Fed moving forward with another 25 basis point rate hike. As one may have anticipated, equity markets fell after the interest rate decision on Wednesday, only to rally the following two days and end the week with healthy gains.

The Dow closed the week up 1.18%, the S&P 500 up 1.39%, and the NASDAQ up 1.66%—really quite remarkable. It appears as if investors are looking for a light at the end of the tunnel, although many commentators are writing that the light may be that of a freight train. As we will explain in our conclusion, that is not our view.

The Economy

Concerns about the health of the banking system added a new dimension over the past two weeks. Two very different but very important issues, bank struggles and inflation, fell right into the lap of the Federal Reserve as they convened for the Open Market Committee Meeting. Last week's Fed meeting was one of great interest to economists and investors alike. The Fed was posed with the question of whether to prioritize the continued fight against inflation by raising interest rates, or, in an attempt to ease pressure on banks, opt to hold rates at their current level. Without hesitation, they continued the fight against inflation and raised interest rates. By the end of the week, investors apparently agreed with this decision, and the market advanced.

Martin Wolf, economist and columnist for the *Financial Times*, titled his last week's column, "Banks are designed to fail—and they do." He goes on to explain that banks are simultaneously meant to be safe havens for the public to store their money and profit seeking takers of risk. The point is, of course, that these goals are contradictory. Wolf's answer is better regulation. It is very likely that we will be hearing quite a bit about the failure of regulation and whether or not more is needed. Perhaps closer enforcement is the answer. Anglo-American economics has always tried to minimize regulation, and, for the most part, this has been very successful. The banking system has been the bedrock of the economy. Confidence is the foundation of the banking system, as it is built on trust. As we wrote earlier, banks are a hybrid, which puts them in a position that requires more regulation and supervision than many other companies.

Conclusion

Although we have listed two serious problems in inflation and the banking system, we believe both are controllable by the Fed. No one really knows the depth of the banking problems, but the most likely outcome is that further bank issues will be limited, and the Fed and FDIC will do their part to ensure stability and confidence.

Inflation is an interesting problem. The reasons behind this particular period of inflation is not just Milton Friedman's notion of having too much money in the system. Instead, it is far more complicated. This time, inflation has been driven by changes in global trade patterns, supply chain interruptions, the war in Ukraine, and, yes, too much money in the system. The U.S. economy's retreat from inflation may be slower than in the past, but it is heading in the right direction.

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