Fixed Income Market Insights

March 30, 2023

Key takeaways

Bond yields turned higher this week, with GT2s up 32 basis points and GT10s higher by 15 basis points and 2s/10s more inverted by 17 basis points (-56), as contagion concerns regarding SVB/SBNY bank failures have partially receded, for now. On the data front, Consumer confidence unexpectedly rose during March to 104.2, driven by an uptick in consumer attitudes regarding business conditions over the next six months and durable job market strength. The S&P CoreLogic Case-Shiller 20-city home price index fell -.43% in January (+2.55% year-over-year), the seventh consecutive monthly decline and smallest annual advance since November 2019, as the union of low affordability and higher mortgage rates have dampened prices from last year's all-time highs. Initial unemployment claims ticked up during the week ended March 25th to 198,000, the first weekly jump in three weeks, as chronically tight labor market conditions continue to dampen layoffs given persistent worker shortages.

We suggest

We continue to prefer playing rate defense given relatively low market rates, accelerating inflationary expectations and ongoing FOMC rate hikes. We favor barbell strategies in securitized products, anchored by short, higher current cash flow assets and longer, high quality bonds.

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Money Fund Surge & Debt Scourge

As markets continue to process future implications of the SVB/SBNY bank failures and Credit Suisse rescue earlier this month, one immediate effect has been a surge in money market fund balances given heightened concerns over the safety of traditional bank deposits. Indeed, nearly $300 billion have poured into money market funds during March, levels not seen since the early months of the pandemic, bringing total assets in these investment pools to an all-time high of $5.1 trillion. Driven by higher yields and investor diversification away from traditional bank deposits, particularly for balances above the $250,000 FDIC insurance ceiling, this disintermediation has primarily afflicted the regional/community banking sector, where deposits have fallen in the aggregate and fueled concerns for a wider credit contraction that could hasten a deeper, more protracted economic downturn later this year. In addition to money market funds, this disintermediation away from deposits at smaller banks has also benefited larger, money center banks, with the former shedding nearly $110 billion in deposits, whilst the largest 25 banks have seen net inflows of $120 billion through the middle of this month, according to Federal Reserve data.

Market Snapshot

	This week 3/30/23	Last week 3/23/23	Basis Points Change	Weekly % Change	YTD % Change
3-month USD Libor	5.16%	5.08%	8	1.57%	8.18%
SOFR	4.83%	4.55%	28	6.15%	12.33%
2-year US Treasury	4.11%	3.79%	32	8.44%	-7.22%
5-year US Treasury	3.67%	3.41%	26	7.62%	-8.48%
10-yr US Treasury	3.55%	3.40%	15	4.41%	-8.51%
2s-10s UST Spread	-56.00	-39.00	-17.00	43.59%	1.82%
DJIA	32,756	32,016	740.00	2.31%	-1.18%
S&P 500	4,037	3,929	108.00	2.75%	5.13%
Spot Gold	1,998	2,015	-17.00	-0.84%	9.42%
WTI (Oil) Current Contract	74.26	69.38	4.88	7.03%	-7.48%
1-year Brokered CD	4.85%	5.15%	-30	-5.83%	5.43%
5-year Brokered CD	4.65%	4.75%	-10	-2.11%	16.25%
5-year Bullet US Agency	3.89%	3.64%	25	6.87%	-4.66%
5-year/NC1yr Callable US Agcy	5.10%	5.00%	10	2.00%	-5.56%
CDX IG Spread Index	78.90	88.07	-9.17	-10.42%	-3.81%
CDX High Yield Index Spread	100.72	99.04	1.68	1.70%	0.10%
15-yr UMBS	4.59%	4.33%	26	6.00%	-1.50%
30-yr UMBS	5.11%	4.89%	22	4.50%	-4.13%

Source: Bloomberg data as of 2:00pm ET 3/30/2023 and 3:00pm ET 3/23/2023

The gravity of this disintermediation away from regional/community bank deposits and potential reduction of credit extension is sobering, particularly given the market share of the nation's lending commanded by small banks. Indeed, recent data have revealed that smaller banks (up to $250 billion in assets) are responsible for nearly 50% of all commercial and industrial lending, with even larger market share when it comes to residential and commercial real estate lending, with estimates of upwards of 60% and more than 70% respectively. To be sure, this magnitude of concentration risk is even more daunting when you consider the amount of commercial real estate (CRE) and investment grade corporate debt maturing both in 2023 and 2024, with estimates of nearly $450 and $500 billion for the former and nearly $800 and $900 billion for the latter. Said differently, borrowers across the spectrum of major economic sectors not only face much higher coupon payments given the sharp rise in interest rates over the past year, but also are confronted with the real prospect of reduced availability of credit given the likelihood of less lending by smaller banks. While the ultimate effects of these mounting headwinds will take months to evaluate, suffice it to say that a veritable perfect storm of higher financing costs, reduced access to credit and durable inflation have materially heightened the risks of a harder economic landing. Judging by the price action in the Federal Funds futures market, which now implies nearly 75 basis points in rate cuts by January 2024, most investors appear to agree. Stay tuned!

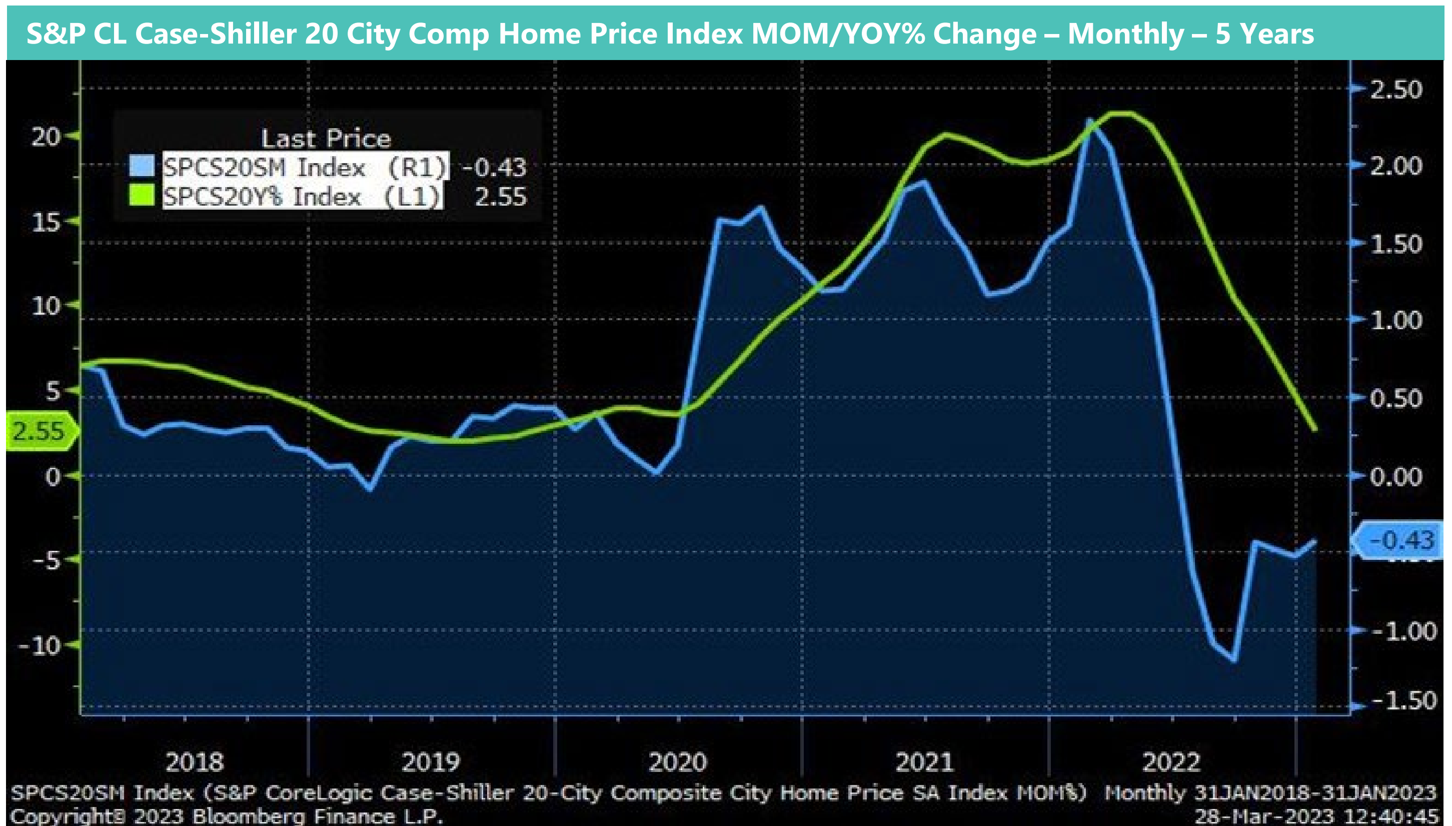
Congress remains quiet on the fiscal front as extended breaks and additional House hearings continue to populate the congressional calendar. Among several legislative imperatives, some contentious negotiations regarding the debt ceiling are imminent given the rapidly approaching date when the government running out of money becomes a real possibility, estimated by many to be sometime this summer. Additionally, look for growing calls for tighter bank regulation in the wake of the SVB/SBNY failures last week, with public hearings likely.

Consumer Confidence & Expectations – Monthly – 3 Years

Source: Bloomberg as of 3/30/2023

Consumer confidence unexpectedly rose during March to 104.2 (vs. 101 est./103.4 Feb.), driven by an uptick in consumer attitudes regarding business conditions over the next six months and durable job market strength. Leading this month's increase was the expectations component, a measure of consumers' six-month outlook, which rose to 73 (70.4 Feb./76 Jan.), a partial reversal of last month's sharp decline, but below the recessionary reading (80) for the eleventh time over the past year as more respondents expect business conditions to improve (15.5% vs. 14.6% Feb.), a lower share see fewer jobs added (19.9% vs. 21.1% Feb.), and more expect income to increase (14.9% vs. 14.4% Feb.). Conversely, the current conditions component edged lower to 151.1 (153 Feb.), led by fewer respondents stating that jobs are plentiful (49.1% vs. 51.2% Feb.) and more seeing weaker current business conditions (19.3% vs. 17.4% Feb.). Looking at the text of the report, the senior director of the survey stated that "Driven by an uptick in expectations, consumer confidence improved somewhat in March, but remains below the average level seen in 2022 (104.5). The gain reflects an improved outlook for consumers under 55 years of age and for households earning $50,000 and over," and that "The latest results also reveal that their expectations of inflation over the next 12 months remains elevated—at 6.3 percent. Overall purchasing plans for appliances continued to soften while automobile purchases saw a slight increase." Notwithstanding persistently elevated inflationary expectations, overall confidence has been bolstered by durable strength in the labor market this year, and March's data revealed another solid read in the Labor Index, which measures the labor differential of jobs plentiful less hard to get, which came in at 38.8% (40.7% Feb/37% Jan.), the second highest level since June 2022. All in all, a reasonably positive report given the SVB/SBNY bank failures earlier this month, but risks of further weakness in consumer spending continue to build given higher interest rates, low personal savings rates and soaring consumer debt, a landscape likely to weaken confidence in the coming months.

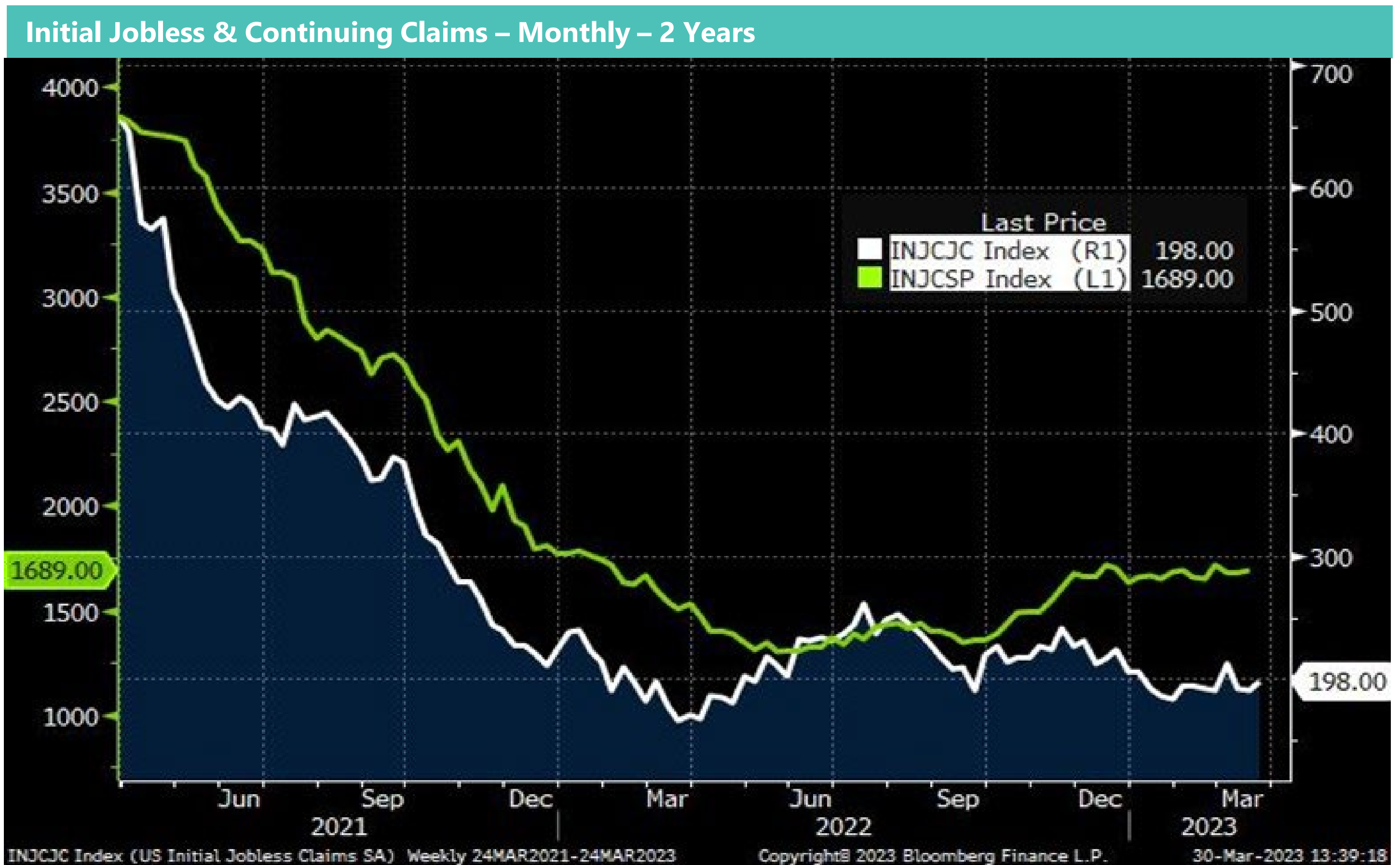
S&P CL Case-Shiller 20 City Comp Home Price Index MOM/YOY% Change – Monthly – 5 Years



Source: Bloomberg as of 3/30/2023

The S&P CoreLogic Case-Shiller 20-city home price index fell -.43% in January (-.50% est./+2.55% year-over-year), the seventh consecutive monthly decline and smallest annual advance since November 2019, as the union of low affordability and higher mortgage rates have dampened prices from last year's all-time highs. While this moderation was inevitable given the dramatic run up in prices from mid-2020, housing market technicals continue to be supportive as supply is still challenged in many areas (2.6 months in Feb./record low 1.8), listings continue to sell quickly (34 days on market in Feb./record low 14) and the rental market remains robust. Regarding inventories, February's existing home sales data revealed that there were 980,000 previously owned homes for sale, down over 20% since last June and marginally higher than January 2022's cycle low of 850,000, which should provide a meaningful buffer to more extreme depreciation in the months to come. In total, 17 of the 20 cities continued to show annual price gains, albeit well-off of their cycle highs last year, with Miami (+13.8%), Tampa (+10.5%) and Atlanta (+8.4%) posting the largest annual gains, with San Diego (-1.4%), Seattle (-5.1%) and San Francisco (-7.6%) rounding out the bottom three. While this rate of price appreciation has surely slowed as affordability continues to slide and mortgage rates remain elevated, demand is still strong and migration away from larger cities should support elevated home prices for much of the country in the near term. On a national basis, the housing price index rose 3.8% for the year ended January, well off of March's 20.8% all-time record high (1988 index inception) and the smallest annual gain since December 2019. In total, home prices nationally fell 0.2% from December and down just 3% from its record high, reached during June 2022. All in all, market participants expected lower home prices given the sharp rise in mortgage rates over the past year and the magnitude of price appreciation during the pandemic, with the former and recent woes in the banking system now likely to drive how far prices will fall into 2023.

Initial Jobless & Continuing Claims – Monthly – 2 Years



Source: Bloomberg as of 3/30/2023

Initial unemployment claims ticked up during the week ended March 25th to 198,000 (191,000 last), the first weekly jump in three weeks, as chronically tight labor market conditions continue to dampen layoffs given persistent worker shortages. Notwithstanding this year's run of historically low initial claims, this series is likely to trend higher over the next few months as the recent uptick in layoff announcements may portend a broader economic slowdown, triggering more layoffs and slower hiring. The four-week moving average of initial claims, which smooths out outsized observations in the data, rose to the highest level since January 14th, coming in at 198,250 (versus 226,000 on Nov 4th), though still muted as job vacancies continue to be plentiful. That said, some initial signs of cooling appear to be brewing given the recent rise in continuing unemployment claims, which increased to 1.689 million (1.498 million on Nov 4th) and include people who have already received unemployment benefits for a week, but still historically low as employers push to absorb the nearly 11 million open positions estimated by the latest JOLTS survey. While total employment has finally exceeded pre-pandemic levels (2+ million jobs), labor participation continues to lag as expanded government assistance, elevated retirements and skill mismatches have stunted employer efforts to attract and retain workers. All in all, the job market remains tight and the claims data presage a slow path to restore better balance between the supply of and demand for labor, which will likely encourage more of the FOMC party line of 'higher for longer' regarding short term interest rates.

The Week Ahead

The data calendar picks up over the next week, headlined by the PCE Deflator, JOLTS Job Openings, ISM Services/Manufacturing and Factory Orders. Looking ahead, markets remain focused on inflation, employment data and more fallout from the SVB/SBNY bank failures. On the new issue front, ABS volumes were again muted given elevated volatility, with 4 deals totaling $3.0 billion priced through the 29th and $63.3 billion year to date ($75.1 billion over same period last year; $276.7 billion for 2022) and IG corporate issuance bounced back given more favorable debt issuance environment with $22.5 billion priced as of the 29th and $393.5 billion year to date ($443.5 billion over same period last year; $1.26 trillion for 2022). While new issue supply slowed last year given FOMC rate hikes and higher volatility, market conditions have generally improved for much of 2023 and the new deal landscape remains favorable for a wider breadth of ABS and corporate issuers as investor demand remains strong, with the caveat that additional fallout from the SVB/SBNY failures will trigger issuance furloughs like observed over the past month.

Friday 3/31

PCE Deflator; MNI Chicago PMI

Monday 4/03

ISM Manufacturing

Tuesday 4/04

JOLTS Job Openings; Factory Orders

Wednesday 4/05

ISM Services; ADP Employment Change

Thursday 4/06

Weekly Jobless Claims

About the author

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As a fixed income trader with more than 25 years of experience, David Petrosinelli brings deep knowledge and unique perspectives to InspereX's clients. His background includes sales and trading of mortgage-backed securities, commercial mortgage-backed securities, asset-backed securities, collateralized loan obligations, and collateralized mortgage obligations. Before joining InspereX (formerly known as Incapital) in 2020, he served as a Managing Director at Brean Capital and previously held various positions with Piper Sandler Companies and Shay Asset Management. David closely monitors underlying trends within the bond markets and how those markets are shaped by both American policymakers and the global macro economy. He earned a bachelor's degree in accounting and finance from Northeastern University and an MBA in economics and finance from Loyola University Chicago. He is a CFA Charterholder and holds FINRA Series 7 and 63 licenses. He is based in New York City.

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