4th Quarter Commentary

2023

White Swans

On November 9, 2023, the Federal Reserve unanimously agreed to not raise the fed funds or discount rates. So, what historically happens next after the Fed stops raising rates and intentionally slows down our economy?

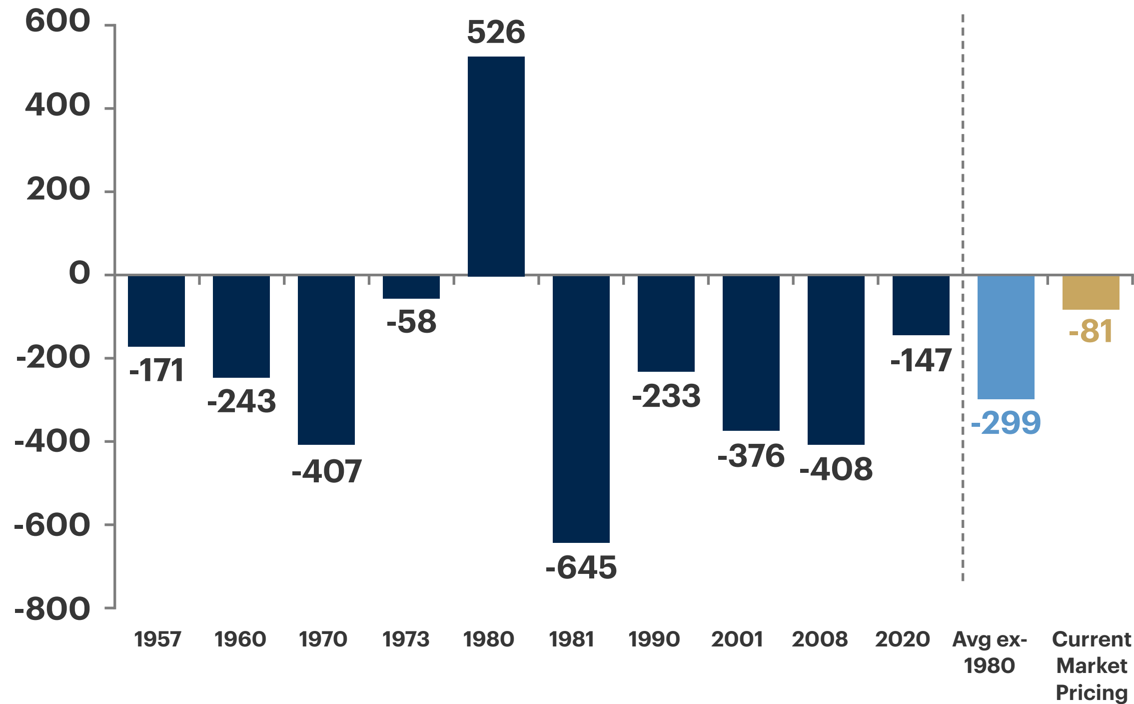
Last quarter, we highlighted the performance of bonds postrate tightening and saw the bond market rebound and recover within a matter of months.

Fixed Income Returns

Hiking Cycle Start	# of Months in Hiking Cycle	During Hiking Cycle	6M After Pause	12M After Pause
3/1988	12	3.7%	8.9%	12.7%
2/1994	13	-1.6%	9.0%	17.1%
3/1997^	1	N/A	6.7%	11.4%
6/1999	12	1.4%	7.7%	13.7%
6/2004	25	5.6%	5.4%	6.5%
12/2015	37	5.7%	6.4%	9.0%
3/2022	12	-7.6%	TBD	TBD
Average	**16**	**1.2%**	**7.4%**	**11.7%**

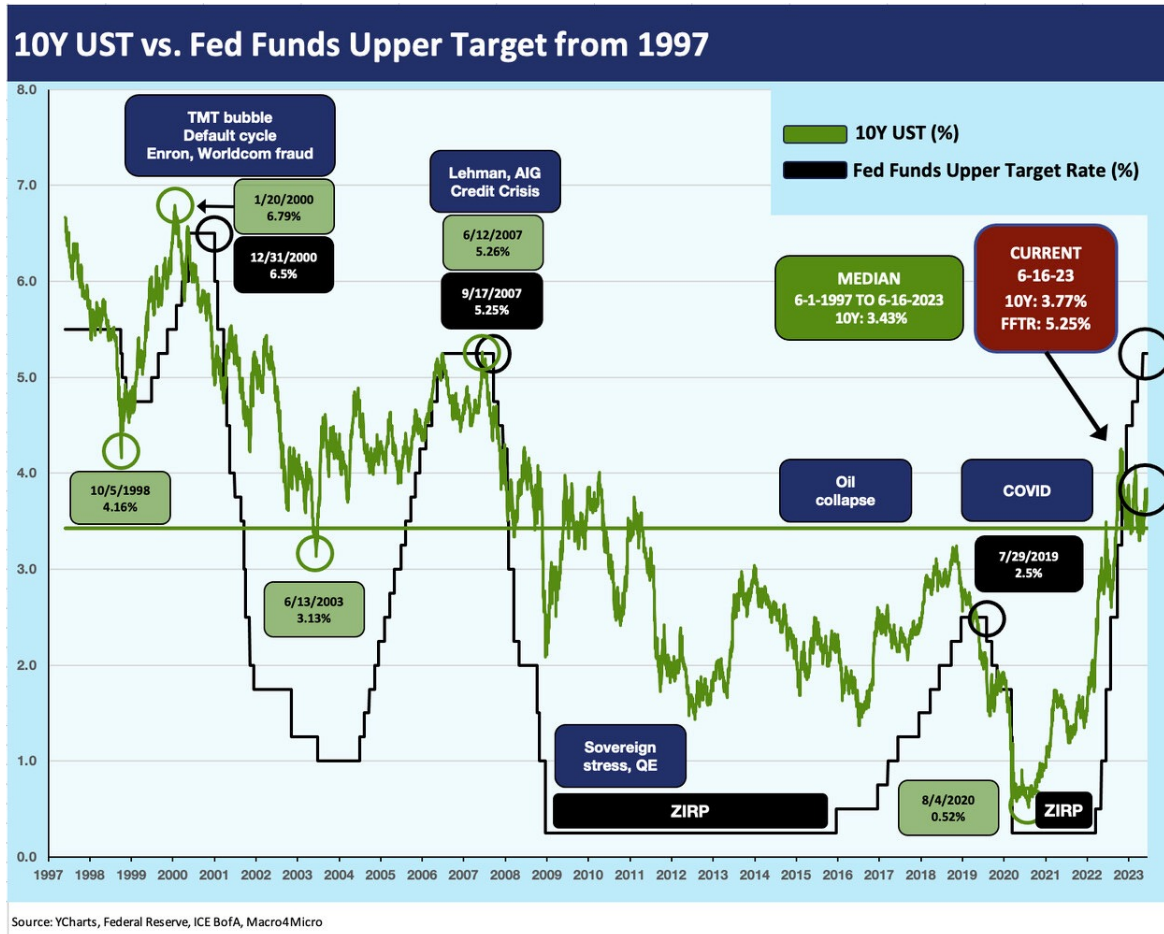
Source: Morningstar as of 2/28/2023. Fixed income cumulative returns are calculated using Bloomberg US Aggregate Index Returns.

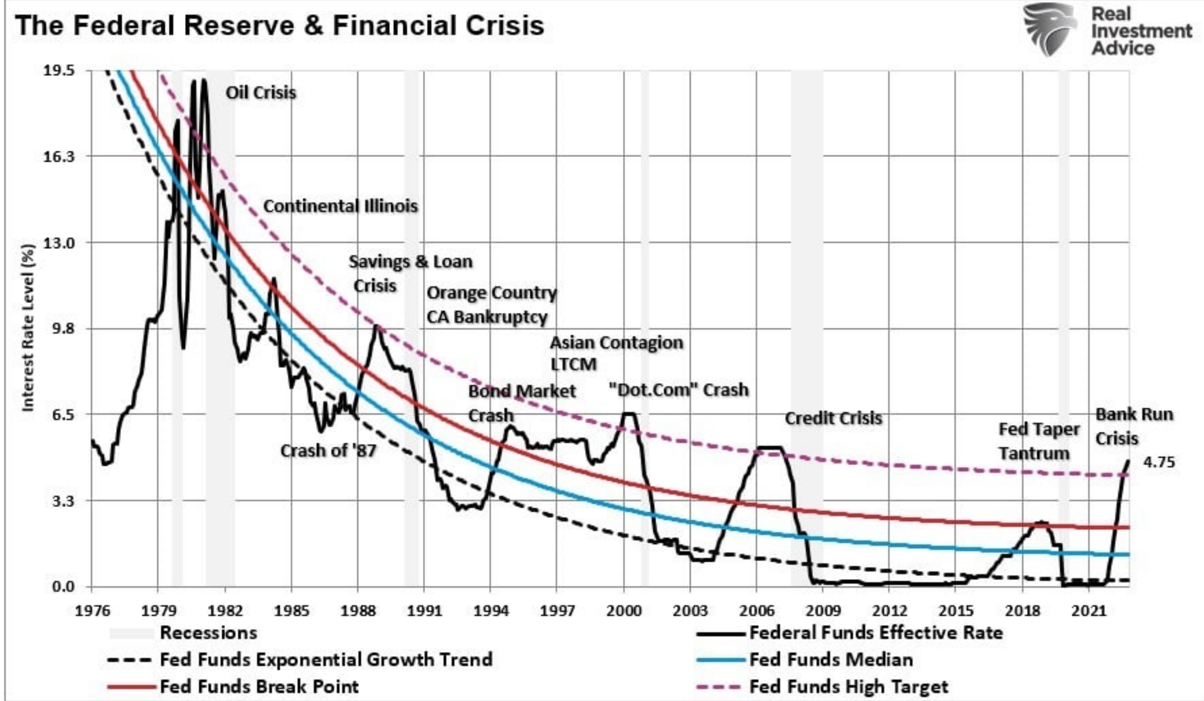
This is only part of the bond and Fed dance. When we have an inverted yield curve as we have starting back in April of 2022, the economy goes into recession 18 months after the inversion. Moreover, the Fed begins cutting rates and the average is 300bps, which translates into around a 2% bond market yield. If the 30-year U.S. Treasury bond goes back down to 2% from 5% that would translate into a 67.43% return and for a 10-year Treasury a 27.04% return for individual Treasury bonds.



Markets respond to all types of crises, including but not limited to, the Dot.com bubble of 2000, the credit crisis of 2007, COVID-19, and now regional banks. Residential and commercial real estate are possible white swans that stoke a recession. This time around we may not need a black swan event with several major markets breaking down before our very eyes.

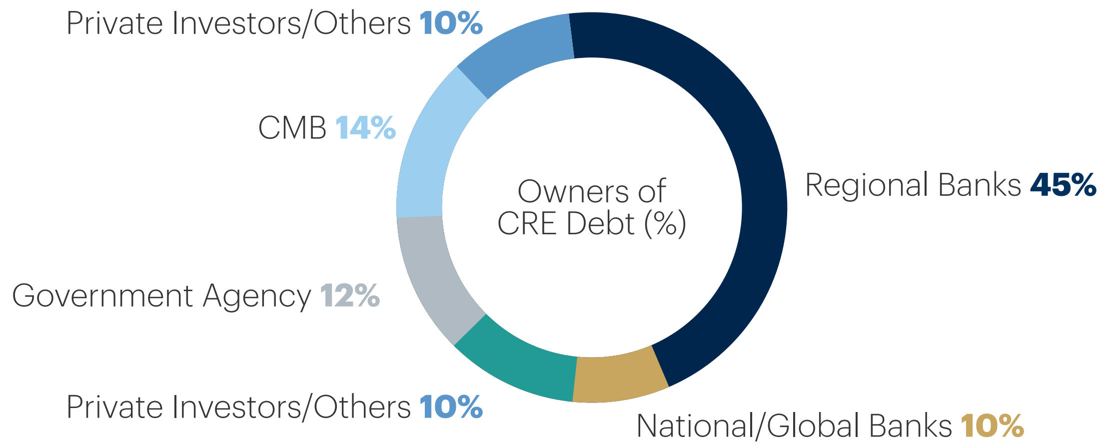
The original issues with regional banks have not gone away, and have gotten worse than what weighed on Silicon Valley Bank, Signature Bank, and First Republic. Fewer deposits, higher rates, a slowing economy, and tighter lending requirements all are in full force. 45% of all funding of commercial real estate resides at regional banks, coupled with over 20% vacancy rates in office buildings showcases significant probabilities of negative economic ripple effects that will weigh on earnings, growth, jobs, and wages. Clearly, this environment is not ideal.

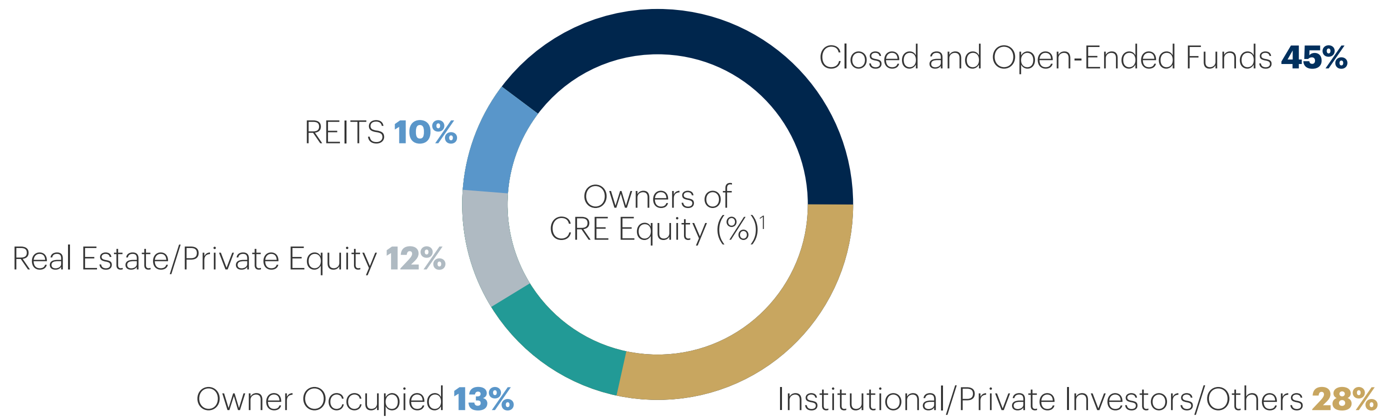




Source: Real Investment Advice

The top banks in the U.S. are preparing their balance sheets for significant losses. Just in the 2nd quarter 2023, Bank of America has positioned $1.7 billion additional dollars for potential Commercial Real Estate (CRE) losses, Goldman Sachs has designated $617 million, JP Morgan Chase has designated $1.1 billion, Wells Fargo $949 million, Citizen Services Financial has a $2.04 billion allowance for credit losses and Fifth Third Bancorp increased its credit losses allowance to $2.53 billion (Reuters).





Source: Autonomous, Mortgage Bankers Association, FED Flow of Funds, SNL (Bank Loans), Morgan Stanley, Statista, McKinsey, NAREIT, Goldman Sachs Asset Management. As of March 31, 2023. Goldman Sachs.

$2 trillion is the estimated loss in value regional banks have already experienced, what is possible with the challenging economic conditions that already exist? The facts are focusing on real and significant headwinds in our foreseeable future. We recommend investors reexamine their financial goals, investments, asset allocation, and risks. We urge investors to reach out to their financial advisors to button up their financial positioning.

Love life,

Todd M. Schwartz
Founder

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