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Fixed Income Market Review - April 2023

In the face of the three very recent bank failures, interest rates barely moved across the curve. The yield curve continues to be inverted in both the 2/10 and 2/30 yield levels.

US Yield Levels

Date	2-year	10-year	30-year
4/28/23	4.04%	3.44%	3.67%
3/31/23	4.06%	3.48%	3.67%
2/28/23	4.81%	3.92%	3.93%
1/31/23	4.21%	3.52%	3.65%
12/30/22	4.41%	3.88%	3.97%
11/30/22	4.38%	3.68%	3.80%
10/31/22	4.51%	4.10%	4.22%
9/30/22	4.22%	3.83%	3.79%
8/31/22	3.45%	3.15%	3.27%
7/29/22	2.89%	2.67%	3.00%
6/30/22	2.92%	2.98%	3.14%
5/31/22	2.53%	2.85%	3.07%
4/29/22	2.70%	2.89%	2.96%
3/31/22	2.28%	2.32%	2.44%
2/28/22	1.44%	1.83%	2.17%
1/31/22	1.18%	1.79%	2.11%
12/31/21	0.73%	1.52%	1.77%
12/31/20	0.13%	0.93%	1.65%
12/31/19	1.58%	1.92%	2.39%

***Source US Treasury Department**

Bloomberg Barclay's Fixed Income Index Returns

Though the Fed has continued to tighten rates, returns for February were very, very negative. Since the start of March, returns have returned to a positive level and I expect will continue to be positive for much of the rest of 2023.

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Index	Apr 2023	Last 3 Months	Last 12 months
Aggregate	0.61%	0.49%	-0.43%
Int Agg	0.58%	0.61%	0.30%
Gov't/Credit	0.63%	0.79%	-0.26%
Int Gov't/Credit	0.61%	1.07%	0.96%
Gov't	0.53%	1.02%	-0.89%
MBS	0.52%	-0.23%	-0.88%
ABS	0.50%	0.94%	1.65%
CMBS	0.86%	0.05%	-0.81%
US Credit	0.79%	0.43%	0.72%
US Corp High Yield	1.00%	0.77%	1.22%

April Economic News

Issued on April 7th the US employment report showed a gain of 236,000 jobs added during March with the unemployment rate declining to 3.5%, just barely above the 53-year low of 3.4% set in January. These numbers are in the face of nine rate hikes by the Fed during the last year period. In fact, as reported by the Wall Street Journal, the US economy has added 5.6 million jobs since the start of 2022.

On April 12th the US Bureau of Labor Statistics reported the CPI climbed 5% in March, down slightly from 6% in February. Though 5% is a high number, it is the ninth straight month of easing price growth, down from a 9% high last June. Represented in this number, food rose 8.5% over the twelve-month period ending with March and rent was 8.3% higher, its largest ever increase over a twelve- month period. It appears to me the unemployment rate will need to rise above the current 3.5% level for inflation to slow. I say this especially since the average price for gasoline is $3.61 per gallon which is already below the $4 a gallon level from a year ago. At the same time, Goldman Sachs reports wage growth is slowing. Earnings are growing at less than 5% per quarter down from 8% per quarter in 2021.

As reported by the Labor Department on April 13th, job openings declined by 10 million at the end of February, the first monthly decline in two years. However, there are still 1.7 vacancies for every unemployed worker.

The Labor Department reported its producer price index for final demand dropped by 0.5% in March, the largest monthly decline since April 2022. The Index was unchanged in February. Two-thirds of the monthly decline came from goods prices declining 0.5% in February, principally from gasoline prices dropping 11.7% for the month while food prices rose 0.6%. Excluding food and energy the price of core goods was up 0.3% for the month, matching the level for February.

As reported on April 28th the Fed's primary index for inflation, the personal consumption expenditures price index excluding food and energy rose by 4.6%. This was 0.1% lower than the

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increase for February. Including food and energy, the headline PCE rose by 0.1% for the month or 4.2% for the last year, down sharply from the 5.1% twelve-month increase ending with February.

The University of Michigan report on consumer sentiment reported expectations about inflation rose from 3.6% in March to 4.6% in April. At the same time, CNN reported home starts fell by 0.8% in March and were now down 17.2% from a year ago. Building permits for new single-family homes were up 2.7% in March from February to 861,000 on an annual basis, though were down from the 1.413 million level of a year ago with prices averaging $438,200, 2.5% higher than a year ago.

The Crisis in the Banking Industry

To repeat from last month what I said about this crisis, I have debated whether to keep this separate from the banking industry or include it under the cryptocurrency heading. The reason for being undecided at that time was it seemed the failure of SVB is concentrated to small and midsize companies in the tech sector, particularly venture capital firms. SVB at its peak was working with 2500 venture capital firms. I was so wrong to think that was the extent of the problem.

As the first shoe that dropped, SVB had been the 16th largest bank in the US with $210 billion in assets. The collapse represented at that time the second largest back collapse in history. Soon after the collapse of SVB, customers of Signature Bank, a $110 billion commercial bank, began a run-on capital with customers withdrawing funds to move to larger banks. Neither SVB nor Signature were subject to the regular, in-depth reviews of their financial health, such as is the case for large banks.

The FDIC sold most of Signature Bank to Flagster, sub of NY Community Bank. Flagster bought $38.4 billion of Signature assets, including $12.9 billion of Signature loans, paying just $2.7 billion for the purchase. Not included in the purchase were $4 billion in digital assets, Bringing digital assets into the equation, on February 8th Binance had announced it was suspending US dollar withdrawals for international customers. Millions of dollars of crypto flowed out of Binance but the company declared it remained “net-positive”. This activity applies only to non-US customers who transfer money to or from bank accounts in dollars. Using data from DefiLlama, net outflows totaled $172 million for the day, relatively insignificant for a company holding $42.2 billion in crypto assets.

Then on March 8th Silvergate announced it was liquidating its bank. Silvergate had been along with Signature bank one of the two primary banks for the crypto industry.

However, as I detailed with last month’s Review, we then had what I believe be the major story for the crypto industry during 2023, this relating to Coinbase (COIN). Two years ago, COIN received a notice from the SEC about a business practice. COIN was allowing users to lend out their crypto and earn interest in the process. COIN ceased this practice when they were told by the SEC it represented the selling of securities.

On March 23rd it was announced the SEC had issued a Wells notice to COIN. A Wells notice is a given in advance an enforcement action. Targeted with the notice are asset listings and staking by COIN.

COIN is the largest crypto exchange. The timing of the notice was very bad for COIN and crypto because bitcoin was up 46% in price since 3/10 SVB collapsed, with bitcoin being a possible alternative to bank deposits.

The last banking crisis to the current one was 2008 with the Federal Government being forced to bail out banks. Crypto emerged for the first time as a possible financial alternative. I doubt whether crypto will be considered this time as the alternative.

The SEC has become more active indicating with the exclusion of bitcoin, most crypto currencies are Securities. The SEC seems ready to apply the Supreme Courts 1946 ruling, the Hovey Test, which defines an investment contract and subjects such contracts to SEC Securities laws.

The SEC is also focusing on staking in which investors lock up crypto tokens with a block chain validator resulting in the reward of additional coins. The SEC has already taken action against the Kraken Exchange that was staking, indicating it represented the sale of securities. Kraken was fined $30 million and shut down its staking activity.

Now back to the banking crisis. First Republic Bank, a fellow Bay area lender to Silicon Valley Bank lost $100 billion in deposits soon after the collapse of SVB. A bailout was attempted was attempted with a $30 billion deposit from a group of large banks, it failed as JP Morgan became the successful bidder and is assuming all $92 billion of First Republic's deposits and most of First Republic's assets including $173 billion in loans and $30 billion in securities. The FDIC will share with JP Morgan losses on First Republic's loans.

The $30 billion initial bailout deposit will be repaid when the purchase is closed. The transaction protects First Republic's depositors but leaves shareholders with nothing as also is the case for SVB and Signature shareholders.

My Economic Outlook

Janet Yellen has clearly stated this week that a budget must be finalized and bills fully paid by June 1st. That is a date that cannot be violated. As great a risk as the violation of this deadline is to the health of the US economy, it seems to me there is a large risk it might be violated. As a result, I will not be providing an outlook unless a budget is finalized by June 1st. Without paying our bills and finalizing a budget, any outlook will be nothing more than a fairy tale.

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Bob Southard
On Behalf of Greenrock Research May 2, 2023

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