

Financial Week Newsletter

...as summarized by Smith Shellnut Wilson

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Equity Markets

- Most major equity indexes finished the week slightly higher after the market seemed to settle into the mid-week invasion by Russia into Ukraine. Volatility does remain elevated, with the VIX close to a two year high.

	<u>2/18 Close</u>	<u>2/25 Close</u>	<u>Price Change</u>
Dow Jones	34,079	34,059	Down -0.1%
S&P 500	4,349	4,385	Up 0.8%
NASDAQ	13,548	13,695	Up 1.1%
KBW Bank Index	137.20	135.94	Down 0.9%
VIX	27.75	27.59	Down 0.6%

Financials

- Regulators closed no additional banks last week; year-to-date closures remain at zero.
- Concerns continue to swirl around the FOMCs timeline for rate hikes, as Bullard and Waller have recently suggested that +100bps by mid-year is necessary. This is creating concerns about rising funding costs and the impact to valuations for financial institutions.

Rates/Credit Spreads

- Nominal yields were up, week over week, with rates between 1-3 years seeing the biggest advance.

	<u>2/18 Close</u>	<u>2/25 Close</u>	<u>Yield Change</u>
3-month Tsy	0.34%	0.34%	Unchanged
2-year Tsy	1.47%	1.57%	Up 10 bps
5-year Tsy	1.82%	1.87%	Up 5 bps
10-year Tsy	1.93%	1.97%	Up 4 bps
2 - 10yr Tsy Spread	+46bps	+40bps	Down 6 bps

- The volatility, in shorter rates, is primarily a result of persistent rising inflation metrics (Core PCE +5.2%, Jan) that continue to touch levels not seen since the early 1980's.
- Short-term rates continue to rise faster than long-term rates, signaling the markets comfort with FOMC rate hikes. Currently, the futures market is forecasting seven 25bp hikes by mid-March 2023. As a result of this short-term rate pressure, the Treasury curve has continued to flatten with the spread between 2 and 10 year Treasuries narrowing to +40 bps, compared to +132 bps a year ago.

- Inflation pressure partnered with global anxiety is placing more pressure on credit. Investment grade corporate credit spreads have increased steadily over the past month and are now close to their 52-week high and the benchmark 10yr AAA municipal to 10yr Treasury ratio has increased from the 55-60% range, a year ago, to the 80-85% range.

Treasury/Fed/Administration/Congress

- Christopher Waller became the first Fed Governor to align with St Louis Fed President James Bullard's call for 100bp of rate hikes by the middle of the summer. It is expected for Jerome Powell to push back on this aggressiveness at his semi-annual testimony to Congress this week. The invasion of Ukraine makes the likelihood of a 50 bp hike at the March FOMC meeting very unlikely.
- The U.S. along with other western countries have substantially ratcheted up sanctions on Russia. There is broader agreement on restricting access to the Swift international payment system for selected Russian banks. This is significant because it will reduce the ability of cross border payments for specific Russian banks. The West also announced sanctions on the Central Bank of Russia (CBR). This is perhaps a more significant move since it will substantially reduce the ability of the CBR to liquidate its foreign assets to support the ruble and help Russian firms service FX-denominated liabilities. Around 40% of Russia's international reserves are held in the financial systems of the countries that have signed up to these sanctions.

Economy

- The U.S. economy grew at slightly faster 7% (GDP) annual pace in the fourth quarter, updated figures show, as Americans boosted spending and businesses rebuilt their stockpile of goods after inventories fell to very low levels. The surge in the U.S. economy at the end of last year hasn't carried over into 2022, however. Omicron blitzed the U.S. in January and consumers cut back. The U.S. is forecast to expand by less than 2% in the first quarter.
- Durable goods orders increased by a solid 1.6% m/m in January, boosted by a 15.6% m/m gain in non-defense aircraft orders. Non-defense capital goods orders (ex. aircraft) increased by a slightly better 0.9% m/m. Shipments in the same category increased by 1.9% m/m last month, however, and that follows a 1.6% gain in December. While these are nominal figures that partly reflect rapid price increases for capital goods, which are in short supply, the strength nevertheless implies that real investment in equipment is beginning to rebound a little too.

This Week

Economic data scheduled to be released this week include Feb. ISM manufacturing (Tues), Feb. ADP Employment (Wed) and Feb. Nonfarm payrolls (Fri).

Quote

"You only live once, but if you do it right, once is enough."

- Mae West

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