MONDAY, MARCH 20, 2023

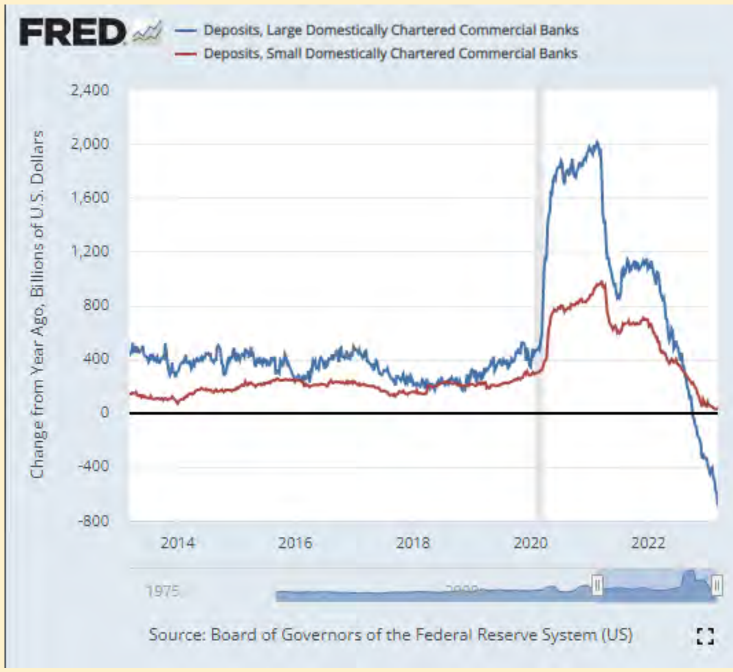
ECONOMIC COMMENTARY

MONTHLY REPORT

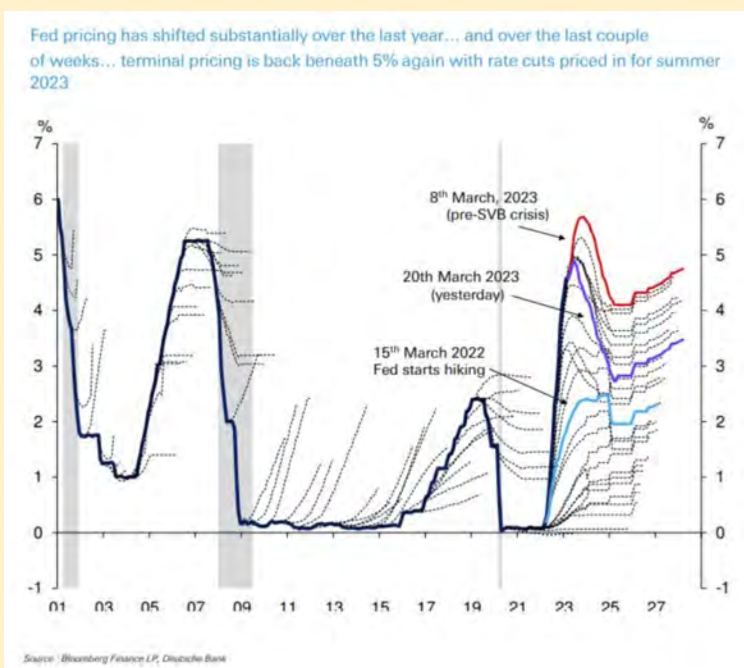
THOUGHTS OF THE MONTH

BANKS:

There has been a noticeable discourse surrounding significant declines in deposits as of late. However, it is worth noting that there has been comparatively little discussion surrounding the rapid decline in deposits within exclusively large banks. Given that the vast majority of these institutions offer low interest rates on deposits, the decrease appears to be a proactive decision rather than a result of any financial pressures.



Although the bond market holds a wealth of information for investors, it has not been effective in accurately forecasting the timing and extent of the Federal Reserve's rate increases or decreases. This is illustrated in a chart that compares the market-implied Fed Funds rates (represented by dotted lines) with the realized Fed Funds rates (represented by dark blue), which shows a less than satisfactory track record.



REAL ESTATE:

Presented in the following table are the bank holding companies with the highest exposure to commercial real estate (CRE). Notably, Wells Fargo and JPM have the greatest exposure, with an estimated range of $130-140 billion. However, given the substantial total assets of these banks at 1.8T and 3.7T respectively, any potential concerns arising from this exposure are relatively limited. Moving forward, we will maintain oversight over any adjustments made to these banks' CRE positions.

Bank Holding Companies with the Largest Commercial Real Estate Loan Portfolio

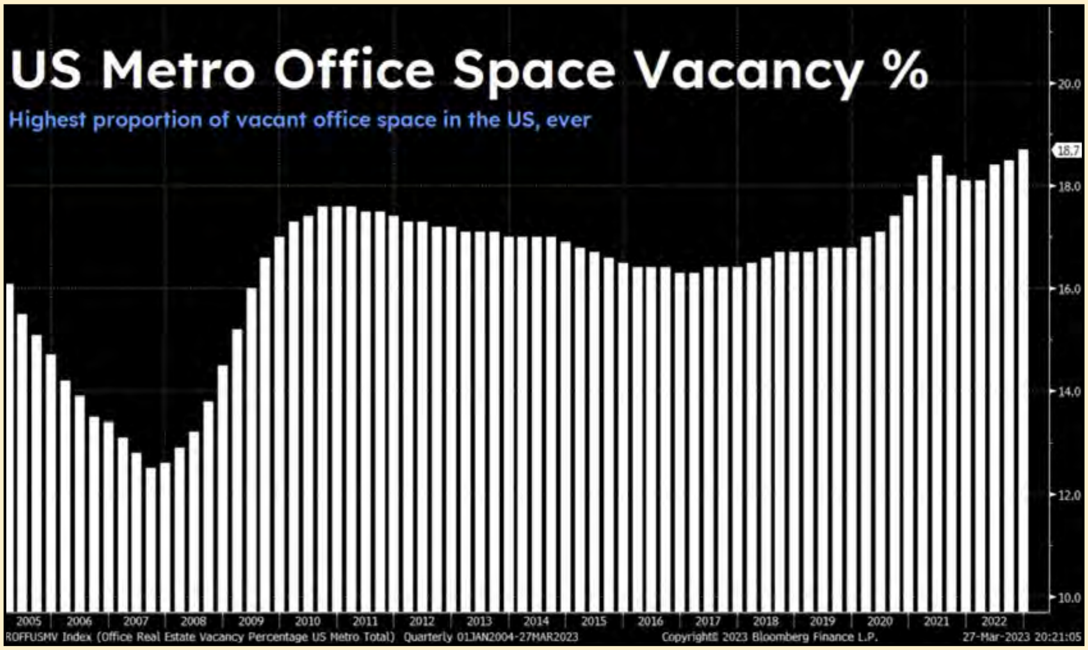
Rank	Company	City	State	Commercial real estate loans Mar. 31 ($000)
1	Wells Fargo & Company	San Francisco	Calif.	$144,136,000
2	JPMorgan Chase & Co.	New York	N.Y.	131,859,000
3	Bank of America Corporation	Charlotte	N.C.	69,792,000
4	The PNC Financial Services Group, Inc.	Pittsburgh	Pa.	47,611,788
5	Capital One Financial Corporation	McLean	Va.	47,500,830
6	U.S. Bancorp	Minneapolis	Minn.	44,882,000
7	M&T Bank Corporation	Buffalo	N.Y.	43,854,227
8	New York Community Bancorp, Inc.	Hicksville	N.Y.	43,379,822
9	Truist Financial Corporation	Charlotte	N.C.	41,699,000
10	Citigroup Inc.	New York	N.Y.	36,983,000
11	Citizens Financial Group, Inc.	Providence	R.I.	29,861,761
12	Valley National Bancorp	New York	N.Y.	23,172,268
13	TD Group US Holdings LLC	Wilmington	Del.	22,755,442
14	KeyCorp	Cleveland	Ohio	19,888,042
15	The Goldman Sachs Group, Inc.	New York	N.Y.	19,394,000
16	CIBC Bancorp USA Inc.	Chicago	Ill.	17,320,488
17	Webster Financial Corporation	Stamford	Conn.	16,900,965
18	East West Bancorp, Inc.	Pasadena	Calif.	16,736,943
19	Morgan Stanley	New York	N.Y.	16,732,000
20	RBC US Group Holdings LLC	Toronto	#N/A	16,713,591

What is CRE? "Commercial real estate" = property for businesses. The US CRE industry is a $20.7 trillion market. Based on the table below from Nareit the Core segments include: offices, industrials, multi families, retail, hotels, and land. While a single $1.7B commercial mortgage default in March 2023 may have spooked markets, this is a bellwether for many more to come. Investors & policymakers need to understand the contagion risk of the CRE loan crisis for & beyond US banks before it's too late.

Estimates of Commercial Property Value: 2021Q2

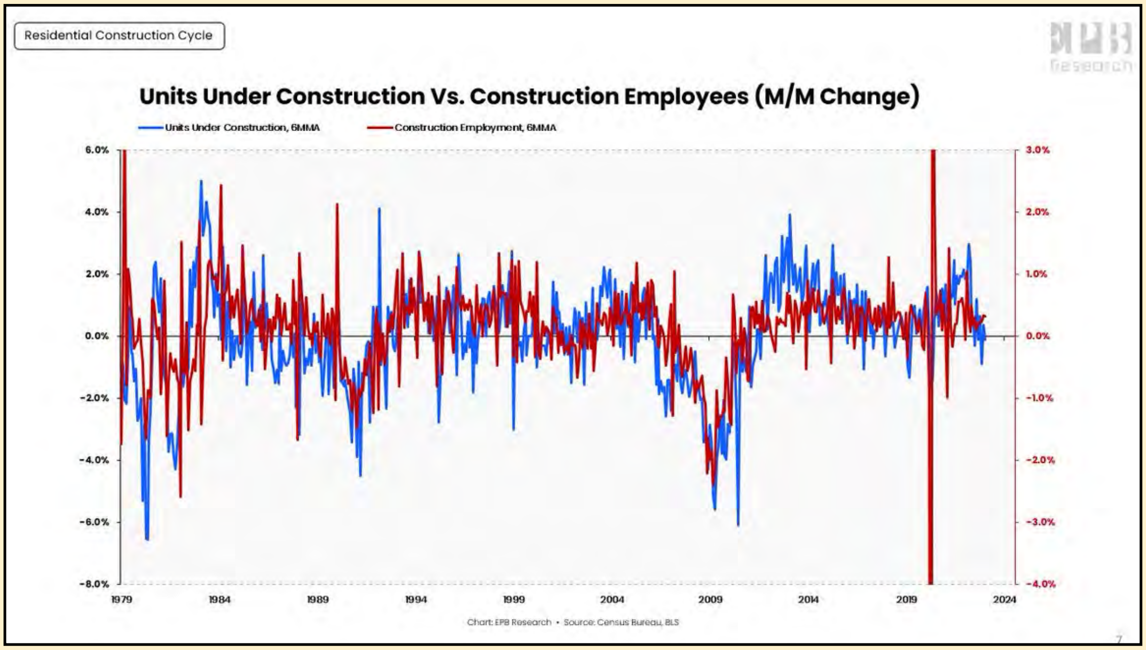
Sector	Base Estimates		
	Square Footage (Millions)	Price per Square Foot ($)	Value ($ Trillions)
Multifamily	16,383	$235	$3.8
Office	11,780	$270	$3.2
Retail	14,040	$207	$2.9
Health Care	2,705	$864	$2.3
Specialty, Sports and Other **	-	-	$3.4
Hospitality	2,625	$617	$1.6
Industrial	21,698	$106	$2.4
Data Centers	-	-	$0.2
Self-Storage	-	-	$0.4
Towers	-	-	$0.4
Total	**69,231**		**20.7**

Vacant office space in the US is at the highest level in 20 years. Office vacancies can have a substantial impact on the commercial real estate market, as it can result in an oversupply of office space, leading to a decrease in rental prices, reduced rental income for landlords, and lower property valuations. This can create financial difficulties for landlords with high levels of debt and signal slower economic growth due to reduced business expansion and employment.

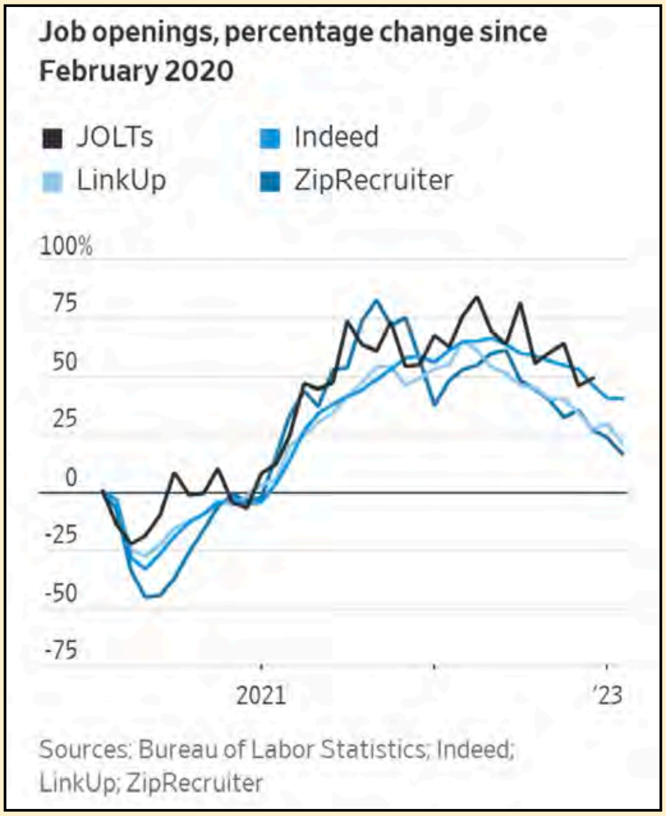


EMPLOYMENT:

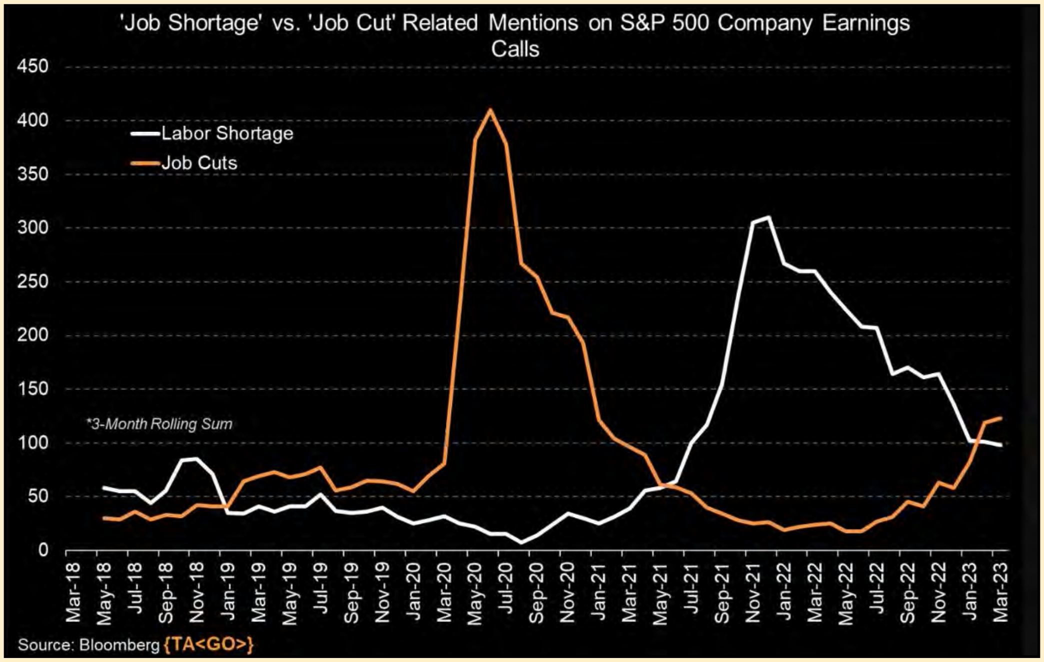
When the number of units under construction starts falling, construction employment falls almost instantly. Remember, construction employment has residential & non-residential. Residential labor reacts concurrently with units. This shows total construction due to limited history.



Based on the graph below provided by Indeed, Bureau of Labor Statistics, ZipRecruiter, and LinkUp, Job openings look to be decreasing but labor markets are still resilient for the time being.

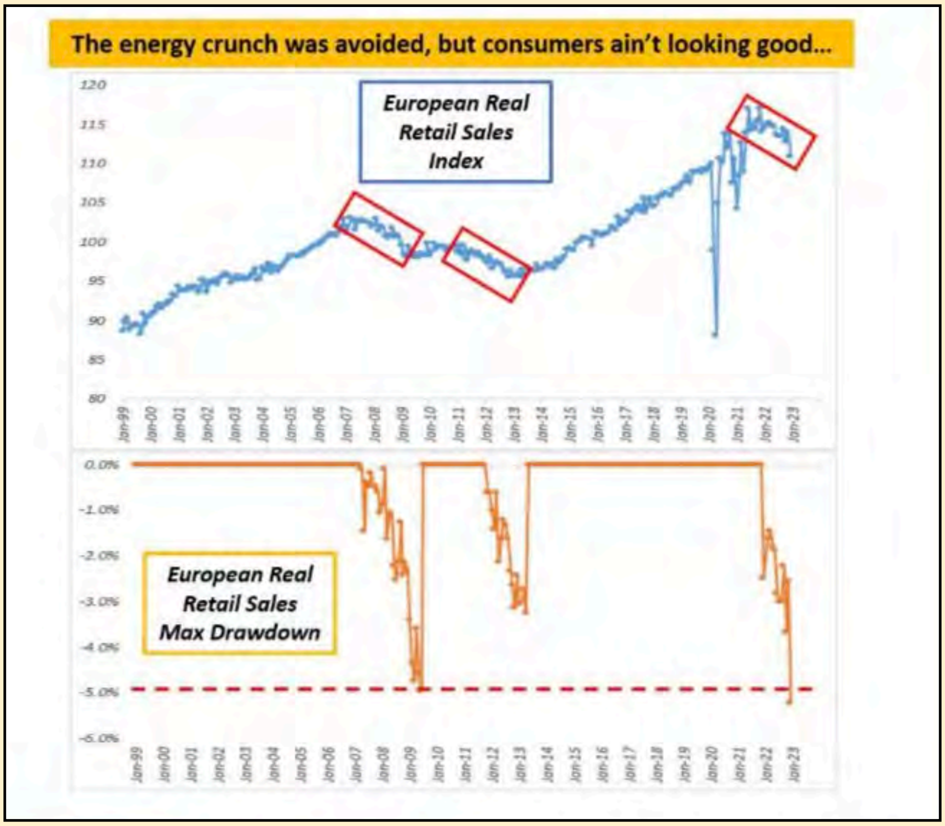


Bloomberg's Chief Economist presented an intriguing chart that showed companies are now more likely to refer to "job cuts" than "labor shortage" in their recent earnings calls. Furthermore, companies are increasingly citing "demand destruction" as the rationale for laying off workers, rather than "cost cutting".

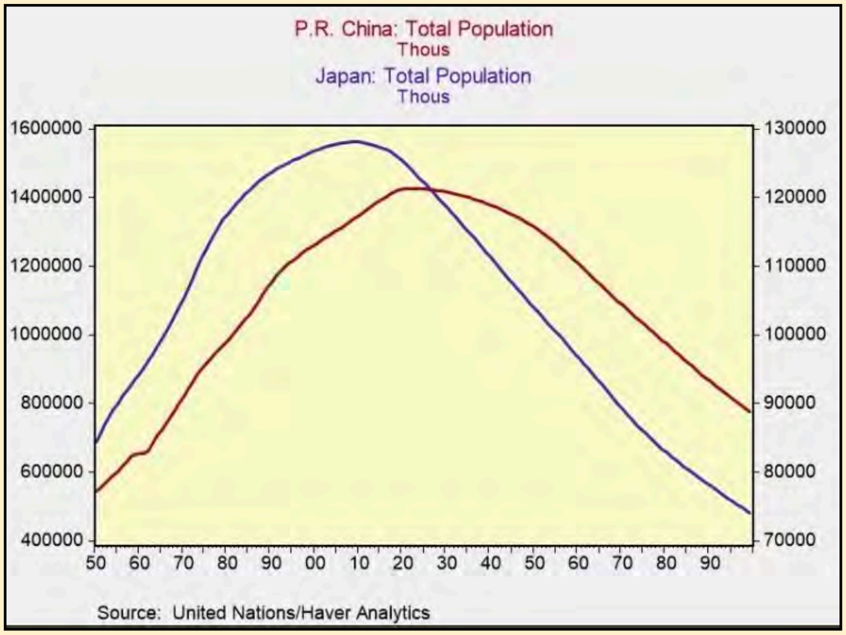


International Markets:

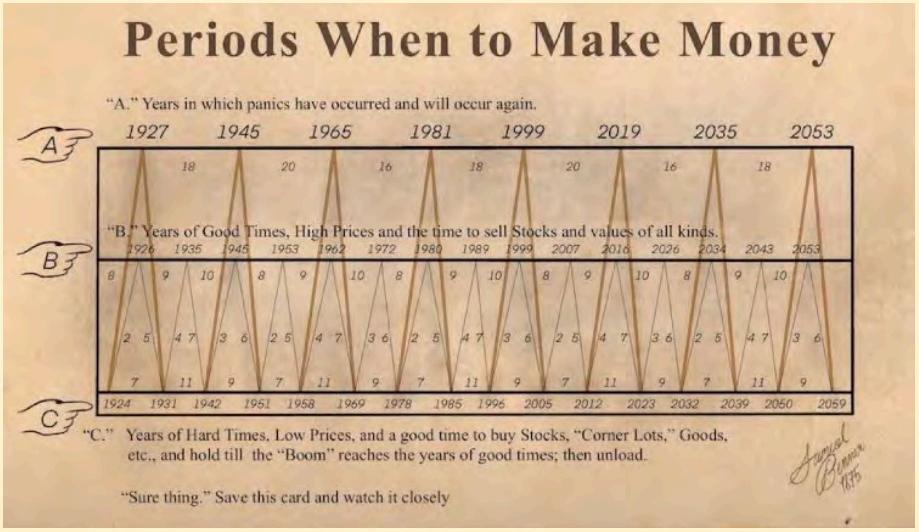
German retail sales adjusted for inflation now in a sustained drawdown on par with the Great Financial Crisis and the Eurozone Debt Crisis. This graph is based on data provided by the Macro Compass.



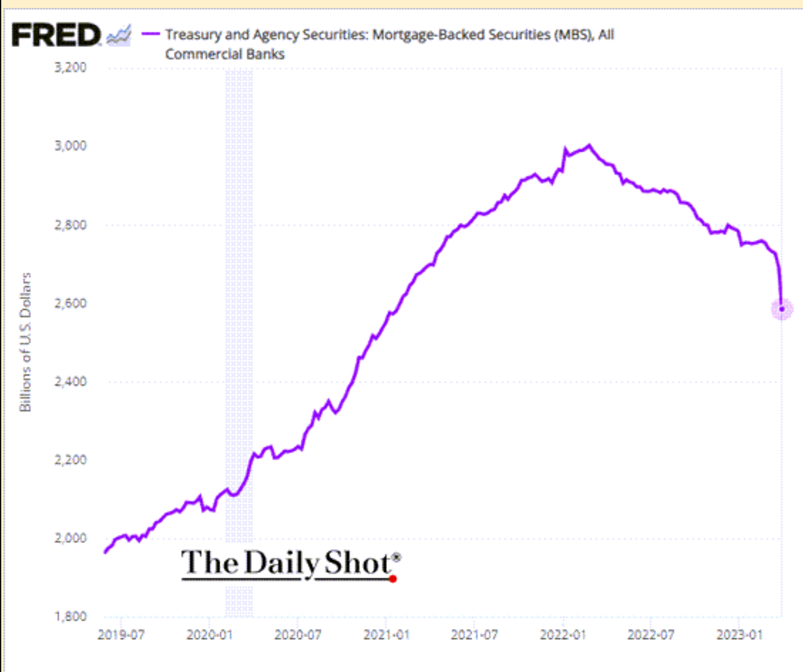
The most important long-term macro chart in the world. The Chinese population trend over the next 20 years will very much resemble the recent Japanese trends.

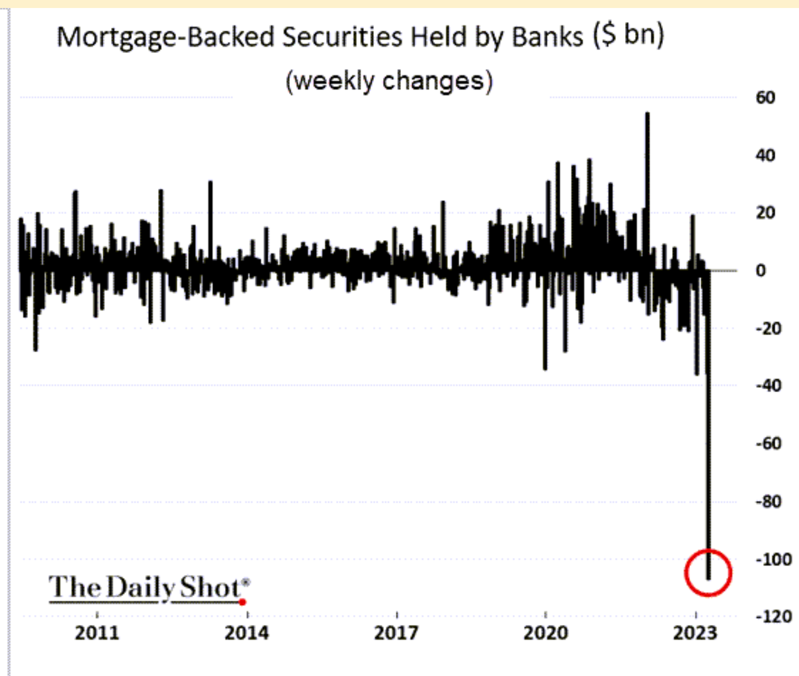


This chart is crazy, made in 1875 by Samuel Benner showing periods of panic, good times to sell assets and good times to buy. Mind blowing that he predicted so many events.



The US banking system dumped almost $110 billion of MBS bonds into the market during the last week of March.





ROUND-UP
INTERNATIONAL ECONOMICS

In the European Union, inflation is still causing problems in some countries such as Germany, while cooling in Spain. As a result, the European Central Bank (ECB) is continuing to raise rates, with some economists believing that the ECB is in a better position than the U.S. Federal Reserve as they have raised interest rates more aggressively and learned from past mistakes. Some analysts predict that a rebound in European economic activity will occur before the United States, but only time will tell.

Switzerland's central bank interfered in the Credit Suisse crisis by providing a quick liquidity injection that eventually led to a forced buyout led by UBS. Although some attribute this to the current economic environment, it is worth noting that Credit Suisse has had ongoing regulatory concerns for some time now.

The emerging markets are showing relative strength as interest rates remain above inflationary levels, the dollar continues to weaken, and economic activity rebounds. However, this trend is not universal across all emerging markets and is more concentrated in specific regions such as the Middle East, Southeast Asia, and parts of South America.

Meanwhile, issues in China and Taiwan continue to create uncertainty in the markets. For the first time, China's population is declining, which raises questions about how China will be able to maintain its large economic manufacturing power and whether this trend is reversible. Furthermore, while China's economic activity, including household consumption and spending, is expected to rebound after the end of Covid-19 policy, some economists believe that the Chinese economy will rebound slower than anticipated. This is evident in the commodity markets.

US MARKETS

EMPLOYMENT

In March 2023, the unemployment rate remained steady at 3.5%, continuing the trend of 12 consecutive months with unemployment below 4%. The job gains were concentrated in sectors such as hospitality, healthcare, and professional and business services, which align with spending and inflation trends in the services industry. Furthermore, the labor force participation rate slightly increased to 62.6%, which is the highest it has been since February 2020. The number of long-term unemployed individuals, defined as those without work for 27 weeks or more, remained largely unchanged at 1.1 million. Nevertheless, the labor market remains tight, presenting a challenge for the Federal Reserve as they consider raising the Federal Funds Rate.

It's worth noting that while low unemployment has historically been a reliable indicator of a healthy economy, it's also been observed that employment tends to hit a low point just before a market downturn. This pattern has been observed in every economic downturn since the Great Depression of 1929. Despite this, the strong performance of the markets across all sectors continues to support the argument that low unemployment has not historically been associated with recessions. It is important however to continue monitoring downward revisions in economic data, rather than focus on the consensus estimates, which a lot of investors seem to be missing.

BANKING & REAL ESTATE

In March 2023, the banking sector faced significant challenges with the failure of three small-to-midsized banks due to mismanagement and duration mismatch in long-term assets. Silvergate and Signature Banks had notable exposure to cryptocurrency, while Silicon Valley Bank experienced duration mismatch. The markets briefly reacted with fear and panic, and customers withdrew their funds. However, regulators responded swiftly to prevent a contagion, and the FDIC and Federal Reserve assured depositors that they would be fully compensated.

Meanwhile, the real estate sector continued to experience a slowdown as interest rates and inflation rose, making it more difficult for people to purchase homes. Commercial Real Estate (CRE) also remained a concern, with banks exposed to around $250 billion in refinancing costs in 2023 and over $2 trillion in the next five years. Rising vacancies and falling rents put pressure on property values, exacerbating the issue.

These challenges are indicative of broader economic challenges facing the United States, and the Federal Reserve is expected to continue raising interest rates to combat inflation. This could have negative effects on certain sectors of the economy. Despite these challenges, the U.S. economy showed signs of resilience in March 2023.