Taylor Wealth Management

BMO Nesbitt Burns

Market Sense: March(ing) Forward

Let's start with the obvious: the last few weeks have certainly seen some capricious markets.

I'd like to say from the outset that financial sector stress should never be taken lightly, but we should also acknowledge that it's nothing new. The sudden collapse of Silicon Valley Bank, Signature Bank, and most recently, Credit Suisse, have all roiled markets in recent weeks, especially when considering that all three events occurred within two weeks earlier this month. Most of the analysis that has taken place since has found some combination of (a) extremely poor risk-management practices, (b) some debatable but nevertheless important regulatory short-comings, and (c) bad luck. One thing we do know for sure is that there are (and always have been) both strong financial firms and weak ones, and some of the weakest have just been exposed. These sudden events are an unwelcome reminder that instability can and will appear from time to time. At the same time, financial markets are so interconnected today that it's more important than ever to be aware of any coincident indicators and other factors than may foreshadow some broader contagion of otherwise-isolated events. Fortunately, these tools do exist and we can see the impact that such events are producing in real time.

The most recent examples of real systemic financial stress are the European Debt Crisis of 2011 and the Global Financial Crisis of 2008. The question that many investors are asking today is whether this crisis will play out similarly. Looking back at those events, there were a variety of specific indicators that called attention to cracks in the foundation before the house actually fell down, so to speak. Those same indicators today (i.e. LIBOR, Corporate Default Swaps, and High Yield interest rate spreads, to name a few), do not show a significant increase in fear in fixed income markets, at least not yet. These tools are highly technical and centre upon how much compensation the market is demanding to own lower quality investments. While rates in these markets have elevated in recent weeks, they are still nowhere near levels of real systematic stress. This can all change, and we must allow for that possibility. However, significantly improved regulation, along with the use of quasi-governmental tools that were designed specifically to combat market stress have helped loosen financial conditions and calm the waters in recent days. In sum, while we are watching and preparing for all outcomes, we do not think this is another

Moving away from systemic banking risk and back to the economy, recent events do have a couple of important takeaways for investors. The first is that further regulatory scrutiny and weakened corporate sentiment will likely impact the economy in the short-term. On the plus side, it may cause inflation to come down faster and more significantly than otherwise. It may even cause central banks of the world to slow or stop raising interest rates altogether in the coming months, as both the Bank of Canada and the Federal Reserve have alluded to in recent statements. For credit markets, the near-constant rise in rates over the past year has left fixed income yields at some of the highest levels in years. For equity markets, the key for this year - as it has always been - is what happens with corporate profits in the underlying economy. Only time will tell, and markets continue to reprice various scenarios in snap judgements.

Against this backdrop, many would be surprised to learn that most equity and bond markets have actually increased in 2023. Perhaps they have started to move on, with an eye towards the eventual end to one of the fastest rate-hiking cycles in history. We must remind ourselves that investing is a forward-looking exercise, and that markets have distinct habit of bouncing back before significant improvement in the real economy. We must also take note of the fact that your investments were selected intentionally - and with great care - as a means to bringing about the achievement of your short and long-term objectives. While all investment mandates require tweaks from time to time, we continue to believe that there are a variety of investments that are suitable for today's volatile markets. And as is plainly evident in the past few weeks or so - the higher the quality, the better.

As always, if you have any questions about current markets news, or if you wish to discuss your own specific investment objectives in more detail, please reach out to us.

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