

SIGNS OF STRESS

The surprise failure of Silicon Valley Bank (SVB) has brought fears of instability of the financial system, sending a shockwave of uncertainty across the capital markets. Very elevated volatility in Treasuries, including a dramatic drop in rates across the curve, highlight investor concerns regarding other potential “shoes to drop.” Equity markets have been more resilient, perhaps acknowledging critical differences to the financial crisis 15 years ago.

We do not think this is the same situation as the financial crisis of 2008. SVB was a unique institution exposed to relatively unique risks. While its failure has exposed underappreciated vulnerabilities, there are critical differences compared to 2008. Far more capital and liquidity combined with much better oversight have dramatically reduced systemic risk. The issues at SVB were “hidden in plain sight”, not accumulated through poor lending standards and off-balance-sheet or complex financial structures that magnified and obfuscated risks. Intervention from regulators to provide liquidity to banks should sufficiently protect the system, though financial markets will likely require the passage of time as proof.

We expect global markets will cycle through a list of potential worries, keeping volatility high in the near term. Stocks have held up surprisingly well in aggregate,

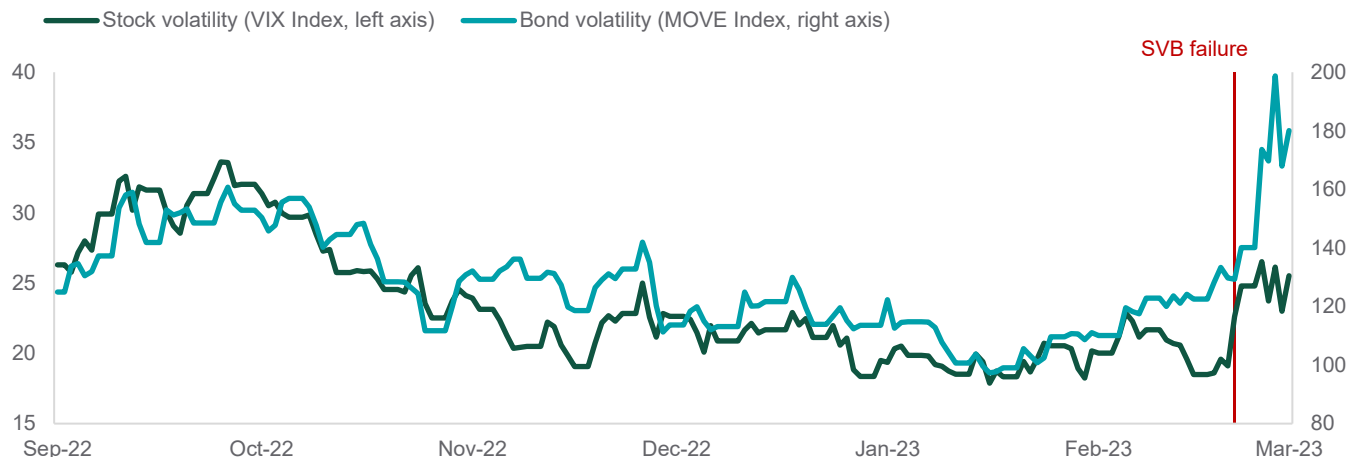
perhaps aided by the drop in rates and changing expectations regarding the path for the Fed, as it and other central banks walk the tightrope of maintaining vigilance on inflation while preserving financial stability.

The duration of this period of uncertainty will have implications on future growth and inflation – the longer this takes to resolve, the larger the drag as businesses and consumers wait out the storm. Meanwhile, the labor market remained strong in February with over 300k new jobs added while wage growth cooled. Producer prices came in lower than expected, hopefully a leading indicator of continued disinflation. In the absence of SVB’s issues, investors would likely have greeted all of this favorably.

We maintained our Global Policy Model allocations this month and see a restoration of market confidence as the base case. We think markets have priced in too negative of an outcome in the fixed income markets, and thus kept our underweight to investment grade bonds and overweight to high yield. Developed market equities appear to fairly price the balance of risks, so we remain neutral. We remain underweight emerging markets with an offsetting overweight to natural resources.

UNCERTAINTY

The SVB failure drove significant volatility in the bond markets. Stock volatility was elevated but notably more contained.



Source: Northern Trust Asset Management, Bloomberg. Silicon Valley Bank (SVB) failure on 3/10/2023. Data from 9/17/2022 through 3/17/2023.

BASE CASE EXPECTATIONS

Dented Confidence

The Silicon Valley Bank failure will likely have a small effect on the supply and demand for credit (small banks lending a bit less and borrowers showing hesitation given uncertainty) but may also have a small effect on the Fed's willingness to continue aggressive rate increases. All said, a modest net negative for the market outlook.

Monetary Tightrope

Given concerns regarding financial stability from unexpectedly rapid rate increases, the Fed will likely resort to a slower path of monetary tightening. But inflation has remained sticky, likely necessitating further rate increases. TAA continues to believe the Fed is close to done raising rates, but will remain there throughout 2023.

RISK CASE SCENARIOS

Labor Market Durability

More persistent tightness in the labor market leads to more stubborn core inflation, necessitating an unexpected monetary policy response that is negative for financial markets.

Debt Dislocations

Further banking fallout (a risk heightened by the steeply inverted yield curve) and/or lack of progress on a debt ceiling deal (which would likely further invert the yield curve) hurts sentiment.

Prepared by Northern Trust Asset Management for Horizon Trust & Investment Management.

UNLESS NOTED OTHERWISE, DATA IN THIS PIECE IS SOURCED FROM BLOOMBERG AS OF JANUARY 2023.

FOR ASIA-PACIFIC MARKETS, THIS INFORMATION IS DIRECTED TO INSTITUTIONAL, PROFESSIONAL AND WHOLESALE CLIENTS OR INVESTORS ONLY AND SHOULD NOT BE RELIED UPON BY RETAIL CLIENTS OR INVESTORS.

© 2023 Northern Trust Corporation. Head Office: 50 South La Salle Street, Chicago, Illinois 60603 U.S.A. The information is not intended for distribution or use by any person in any jurisdiction where such distribution would be contrary to local law or regulation. This information is obtained from sources believed to be reliable, and its accuracy and completeness are not guaranteed. Information does not constitute a recommendation of any investment strategy, is not intended as investment advice and does not take into account all the circumstances of each investor. Forward-looking statements and assumptions are Northern Trust's current estimates or expectations of future events or future results based upon proprietary research and should not be construed as an estimate or promise of results that a portfolio may achieve. Actual results could differ materially from the results indicated by this information. Investments can go down as well as up.

This report is provided for informational purposes only and is not intended to be, and should not be construed as, an offer, solicitation or recommendation with respect to any transaction and should not be treated as legal advice, investment advice or tax advice. Recipients should not rely upon this information as a substitute for obtaining specific legal or tax advice from their own professional legal or tax advisors. References to specific securities and their issuers are for illustrative purposes only and are not intended and should not be interpreted as recommendations to purchase or sell such securities. Indices and trademarks are the property of their respective owners. Information is subject to change based on market or other conditions.

No investment strategy or risk management technique can guarantee returns or eliminate risk in any market environment. Risk controls and models do not promise any level of performance or guarantee against loss of principal. Any discussion of risk management is intended to describe Northern Trust's efforts to monitor and manage risk but does not imply low risk.

Past performance is not guarantee of future results. Performance returns and the principal value of an investment will fluctuate. Performance returns contained herein are subject to revision by Northern Trust. Comparative indices shown are provided as an indication of the performance of a particular segment of the capital markets and/or alternative strategies in general. Index performance returns do not reflect any management fees, transaction costs or expenses. It is not possible to invest directly in any index. Net performance returns are reduced by investment management fees and other expenses relating to the management of the account. Gross performance returns contained herein include reinvestment of dividends and other earnings, transaction costs, and all fees and expenses other than investment management fees, unless indicated otherwise. For additional information on fees, please refer to Part 2a of the Form ADV or consult a Northern Trust representative.

Forward-looking statements and assumptions are Northern Trust's current estimates or expectations of future events or future results based upon proprietary research and should not be construed as an estimate or promise of results that a portfolio may achieve. Actual results could differ materially from the results indicated by this information.

Northern Trust Asset Management is composed of Northern Trust Investments, Inc., Northern Trust Global Investments Limited, Northern Trust Fund Managers (Ireland) Limited, Northern Trust Global Investments Japan, K.K., NT Global Advisors, Inc., 50 South Capital Advisors LLC, Northern Trust Asset Management Australia Pty Ltd, and investment personnel of The Northern Trust Company of Hong Kong Limited and The Northern Trust Company.

ViewPoints reflects data as of 3/21/23.

Horizon Trust & Investment Management

For more information please contact:

John Richards, CFP®
President

Paul Fleming, CFA, CAIA®
Investment Director

Brad Murzyn, APMA™
Investment Officer

Powered by



©2023. All Rights Reserved.