See Our Latest Intelligence Briefings & Learn More About MRP's Product Lineup Here

MRP MCALINDEN RESEARCH PARTNERS

mcalindenresearchpartners.com

Daily Intelligence Briefing

Monday, March 13, 2023

Identifying Change-Driven Investment Themes

THEME ALERT: AN ACTIVE MRP THEME

I. Today's Thematic Investment Idea

A deep dive into a market driver with alpha generating potential.

Gold Demand Remains Robust as Banking Breakdown Threatens to Bust Rate Hike Projections

Summary: Gold prices have shrugged off chaos in equity and bond markets over the last week, rallying back above $1900.00. While some central banks are loading up on gold, others are figuring out how to stem financial sector turmoil and the risk of bank runs. The US's second-largest bank failure in history has thrown the Federal Reserve's tightening regime into question and forced them to start up a lending facility backed by the US Treasury. That indicates trouble brewing under the surface and this first measure to sure up banks' liquidity may not be the last.

Related ETFs: SPDR Gold Shares (GLD), SPDR S&P Bank ETF (KBE)

Central banks globally added another net 77 tons to their gold reserves in January, according to the World Gold Council (WGC). That data indicated a 192% MoM increase, helped along by Singapore boosting its gold reserves by 44.6 tons. That purchase was the Monetary Authority of Singapore's (MAS) second-largest single purchase ever, equivalent to a 30% gain in their overall reserves. Early indications for February's haul are signaling the potential for another notable gain, as China appears to have added to its gold reserves once again. That follows a spate of disclosed purchases throughout the prior three months.

Per WGC, Central banks added 1,136 tonnes of gold worth some $70 billion to their stockpiles in 2022, by far the most of any year in records going back to 1950. That sum was bolstered by a particularly strong third quarter of central bank gold buying – a pattern MRP noted back in November – which helped gold reverse seven straight months of decline. Per Deutsche Bank, that was the metal's worst losing streak since 1869.

While the S&P 500 dumped almost -5.0% throughout the week to March 10, gold was holding strong and even managed to move up 2.3% following a rally toward the end of the week. As of Monday morning, gold held even more gains, breaking the $1,900.00 mark for the first time since February 3.

An ongoing financial sector wipeout, which has seen the liquidation of one bank, and the failure of two others who have now gone into receivership with regulators, has drastically shifted the outlook for monetary policy and boosted gold's prospects. The latter two banks, now shuttered, are Silicon Valley Bank (SVB) and Signature Bank, carrying cumulative consolidated assets totaling more than $338 billion. SVB's failure was the second-largest bank failure in US history, trailing only Washington Mutual in 2008.

These failures have been triggered by a sudden exodus of deposits out of banks – particularly among large accounts. These withdrawals have two key causes, with the first being liquidity needs among companies that have seen business slow and costs rise. The second, and perhaps more consequential cause, is the Federal Reserve's rapid pace of rate hikes and a resulting inversion of the yield curve.

SVB, along with Silvergate Bank, which went into liquidation not long before SVB collapsed, had faced a particularly strong wave of withdrawals due to much of their client base being tied to the tech sector, where startup fundraising and IPOs have dried up. These companies were pulling funds to keep the lights on and the only way SVB could meet all withdrawal requests was to sell off $21 billion in low-yielding bonds and realize a massive loss of -$1.8 billion. SVB tried to make up for the loss by selling off equity to raise capital, but this only incited more panic as depositors lined up more withdrawals and the stock price of SVB imploded in the course of just two days.

Massive losses that SVB faced on its long-dated treasuries, mostly purchased when interest rates were much lower than they are today, and bond prices much higher, is not an isolated issue. At the end of 2022, US banks were sitting on -$620 billion in unrealized losses, largely fueled by US Treasuries. If banks can hold treasuries to maturity, losses never have to be realized, but fears of bank runs are now weighing on investors' confidence. If banks do not have enough liquidity to meet withdrawal requests, they would need to sell assets to honor queued withdrawals and likely realize losses on bonds like SVB did, or face insolvency. The incentive for depositors to pull their money is heightened by the fact that banks are paying very little interest on deposits and can hardly afford to pay more with so much of their money tied up in long-dated treasury notes that now yield less than short-term bills. If banks can't provide adequate interest or the feeling of security for their customers, why should firms trust their cash with a depository institution when they can guarantee safety and a superior return in a short-term bond?

Bank shares have tumbled across the board as fears of contagion spread. In just a week, the SPDR S&P Bank ETF (KBE) has lost -14.1% and is falling even further this morning. As of Monday's open, shares of First Republic bank were down -65.0%, with other substantial declines witnessed across the regional banking space as a whole.

Per the Wall Street Journal, the US Treasury Department has announced it is providing $25 billion of credit protection to the Fed to help backstop a new Bank Term Funding Program (BTFP), which will allow banks to take advances from the Fed for up to a year by pledging Treasuries, mortgage-backed bonds and other debt as collateral. Though that may help to stem some of the strain banks are likely to face this week from panicked depositors, it remains to be seen if the backstop funds will be a sufficient sum.

All of this has coincided with the release of some concerning employment data throughout the past week, which could further complicate the Fed's rate hike path.

US Department of Labor (DoL) data showed new claims for unemployment benefits in the US jumped by 21,000 to a total of 211,000 in the week ended March 4, their highest level thus far in 2023. That was the largest weekly increase since last October and easily surpassed a forecast from economists polled by The Wall Street Journal, which estimated there'd be just 195,000 claims.

Surging initial claims shifted the 4-week moving average to 197,000, a fourth consecutive increase. Continuing claims rose by 69,000 to 1.718 million, their highest level in more than a year. That pushed combined initial and continuing claims to a 9-week high. Additionally, despite a gain in nonfarm payrolls, the unemployment unexpectedly jumped to 3.6% in February, the highest level since November

This sudden uptick in unemployment claims coincides with some other concerning jobs data. Challenger, Gray & Christmas, Inc. reported 77,770 US job cuts were announced last month, the most cuts recorded in any February going back to 2009. Combined with January's 102,943 job cut announcements, employers have disclosed plans to cut 180,713 jobs, up 427% from the 34,309 cuts announced in the first two months of 2022. Additionally, the BLS's gauge of layoffs, reported yesterday, rose to 1.716 million in January, its highest reading since December 2020.

All of this further cements our conviction that the Fed has already passed the point of "Peak Hawkishness". Although the Fed may continue to raise interest rates for an indefinite period going forward, we've noted since last August that the size and frequency of rate hikes had likely reached a peak and the central bank would soon begin to pull back on one or both of those variables. Since then, the Fed has gradually diminished its rate hikes from 75bps to just 25bps. As of this morning, the probability of any rate hike for March is falling fast, with CME's FedWatch tool indicating a 55% chance of unchanged rates at the March 22 FOMC meeting.

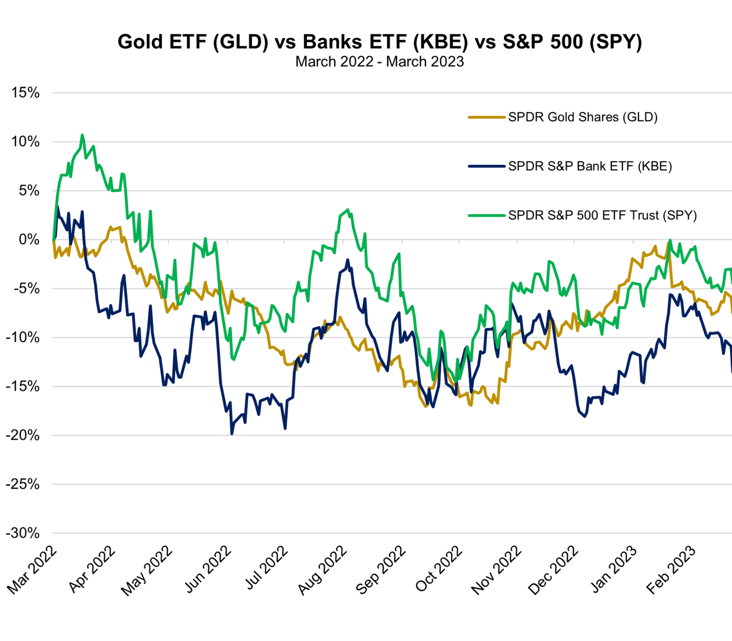
THEME ALERT - LONG Gold

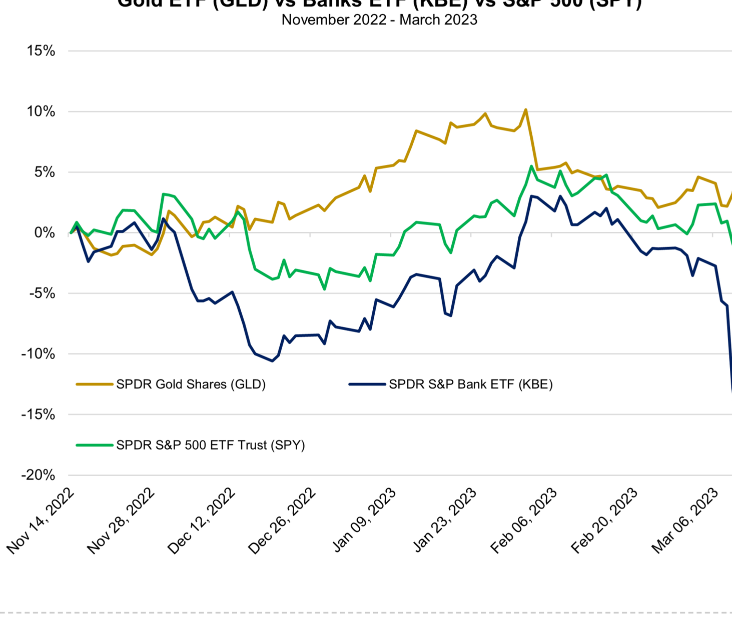
Though gold was on quite the losing streak through most of 2022, that did not stop some of the largest financial institutions in the world from increasing the pace of their accumulation, as central banks bought a record 399 tonnes of gold worth around $20 billion in the third quarter of 2022 alone. That's according to the World Gold Council (WGC), who notes that haul far exceeds the previous quarterly record in data stretching back to 2000 and took total central bank purchases for the year to 673 tonnes through September; more than the total purchases in any full year since 1967.

The recent jump in central bank buying is only an escalation of an already existing trend that goes back to last year. Central banks added 463 tons to reserves in 2021 as well, an increase of more than 80% from the year prior, per WGC data. Bank failures and a new Federal Reserve facility meant to backstop deposits shows that something is brewing under the surface in the US banking system, threatening to disrupt the monetary tightening taking place in the US – undoubtedly the primary variable that suppressed gold prices throughout 2022. If the size and volume of rate hikes has passed their peak, that signals a possible turning point for gold.

MRP added LONG Gold to our list of Active Themes on November 14, 2022. Since then, the SPDR Gold Shares (GLD) fund has returned 5%, outperforming an S&P 500 decline of -2% over the same period.

CHARTS





Supplemental material for today's market insight...

TOP

Banks

Declining U.S. bank reserves add wrinkle to contentious debt ceiling issue

The last time the Fed undertook quantitative tightening (QT), it ended abruptly after bank reserves dropped in September 2019 below the minimum needed to ensure the smooth functioning of short-term funding markets. That prompted a spike in repo rates and forced the Fed to provide additional reserves to the banking system.

An expected shortage of bills as the United States hits the debt ceiling and the Treasury must curtail borrowing, is also seen reducing reserves further. The U.S. government came close to its $31.4 trillion debt limit earlier last month, prompting a Treasury warning that it may not be able to avert default past early June.

Read the full article from Reuters +

Banks

Goldman Sachs no longer expects the Fed to hike rates in March, cites stress on banking system

"In light of the stress in the banking system, we no longer expect the FOMC to deliver a rate hike at its next meeting on March 22," Goldman economist Jan Hatzius said in a Sunday note. The firm had previously expected the Federal Reserve to hike rates by 25 basis points.

Read the full article from CNBC +

You'll find all of our recent Market Insight reports on the MRP website →

VIEWPOINT ARCHIVE

TOP

Joe Mac's Viewpoint

Founder Joe McAlinden's big-picture analyses of macro issues. More about him here.

March 3, 2023: A Tough and Tighter Year Ahead →

January 11, 2023: A Look Back at 2022: Reviewing Our List of Themes →

November 22, 2022: Less Rich, But Not Cheap →

October 4, 2022: The "Real" Rate Story →

August 8, 2022: The FX Timebomb →

ACTIVE THEMATIC IDEAS

TOP

Select a theme to see when and why we added it. Also included is a link to all recent Market Insight reports we've written about that theme, allowing you to track its progress.

Click here to review the performance history of closed themes →

LONG Travel & Leisure

LONG Aerospace & Defense

LONG Gene Editing

LONG Cybersecurity

LONG Gold

LONG Pharmaceuticals

LONG Saudi Arabia

LONG Solar

ONLINE RESEARCH PORTAL

MRP's Research Portal includes an archive of current and past Market Insights, Active Thematic Ideas, and Joe Mac's Viewpoints. You can also search for all of our coverage on any sector or industry either by selecting Research Sectors or by entering a keyword such as "oil", "housing" or "inflation" into the search bar at the top right of the page.

If you're having trouble signing in, or have any questions, send an email to joe@mcalindenresearch.com.

ABOUT THE DIBS AND MCALINDEN RESEARCH PARTNERS

McAlinden Research Partners (MRP) publishes daily and other periodic reports on the economy and the markets.

MRP focuses on identifying change in the global economy and offering an investment thesis whenever an opportunity arises that has not yet been recognized by the market. The DIBs are MRP's compilation of articles and data from multiple sources on subjects reflecting change that have potential investment implications for an industry or group of securities. We share these with our clients who may already have or may be considering exposure in the industries affected. The subjects change daily and constitute an excellent update on featured topics.

The information provided in this Report is not to be reproduced or distributed to any other persons. This report has been prepared solely for informational purposes and is not an offer to buy/sell/endorse or a solicitation of an offer to buy/sell/endorse Interests or any other security or instrument or to participate in any trading or investment strategy. No representation or warranty (express or implied) is made or can be given with respect to the sequence, accuracy, completeness, or timeliness of the information in this Report. Unless otherwise noted, all information is sourced from public data.

McAlinden Research Partners is a division of Catalpa Capital Advisors, LLC (CCA), a Registered Investment Advisor. References to specific securities, asset classes and financial markets discussed herein are for illustrative purposes only and should not be interpreted as recommendations to purchase or sell such securities. CCA, MRP, employees and direct affiliates of the firm may or may not own any of the securities mentioned in the report at the time of publication.

FOR MORE INFORMATION

Rob Davis
Managing Director

(646) 964-6152

rob@mcalindenresearch.com

FIND US AT

mcalindenresearchpartners.com