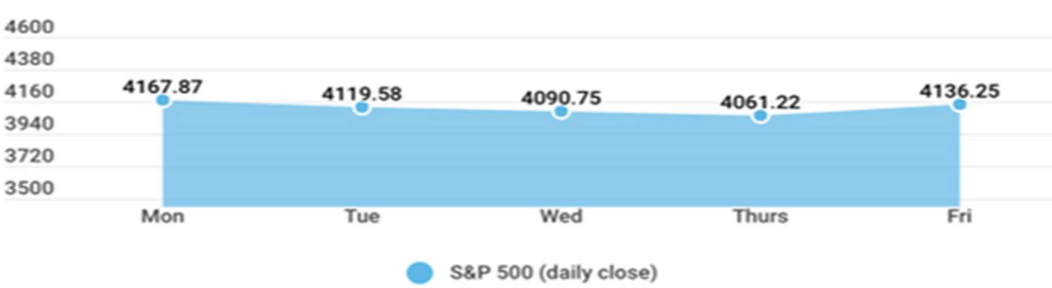
Weekly Economic Update May 8, 2023

A Friday rebound, triggered by a big tech company's earnings beat and a strong jobs report, shaved much of the week's accumulated losses.

The Dow Jones Industrial Average fell 1.24%, while the Standard & Poor's 500 lost 0.80%. The Nasdaq Composite Index was flat (+0.07%) for the week. The MSCI EAFE index, which tracks developed overseas stock markets, slipped 0.62%.[1,2,3]

Market Index	Close	Week	Y-T-D
DJIA	33,674.38	-1.24%	+1.59%
NASDAQ	12,235.41	+0.07%	+16.90%
MSCI-EAFE	2,130.58	-0.62%	+9.60%
S&P 500	4,136.25	-0.80%	+7.73%



	Treasury	Close	Week	Y-T-D
	10-Year Note	3.44%	+0.01%	-0.44%

Sources: The Wall Street Journal, May 5, 2023; Treasury.gov, May 5, 2023
Weekly performance for the Dow Jones Industrial Average, Standard & Poor's 500 Index, and NASDAQ Composite Index is measured from the close of trading on Friday, April 28, to Friday, May 5 close. Weekly performance for the MSCI-EAFE is measured from Friday, April 28, open to Thursday, May 4 close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

Stocks See-Saw

Renewed regional bank concerns weighed on investor sentiment last week, despite the rescue of a troubled bank before the start of the trading week.

But worries were not isolated to regional banks. Secretary of the Treasury Janet Yellen commented that the federal government may hit its debt ceiling earlier than expected, heightened investor jitters over a potential technical default. The stock market also slipped in the wake of the latest rate hike decision by the Federal Open Market Committee (FOMC).

Solid earnings from one mega-cap tech firm and a strong employment report steadied investors, resulting in a Friday bounce that ended a volatile week on a positive note.

Fed Hikes Rates

Amid concerns in the regional bank sector and tightening credit conditions, the Fed elected to increase interest rates by 0.25%, citing elevated inflation and robust job gains. Investors were more focused, however, on what the Fed signaled about its plans since the expected rate hike.

The Fed indicated it may pause further rate hikes, suggesting that future decisions will be based on economic data and prevailing financial conditions. Following the announcement, interest rate traders assigned an 89% probability that rates would remain unchanged following the next meeting of the FOMC in June.[4, 5]

This Week: Key Economic Data

Wednesday: Consumer Price Index (CPI).

Thursday: Producer Price Index (PPI). Jobless Claims.

Friday: Consumer Sentiment.

Quote of the Week

"It's one thing to understand the decline to empires and civilizations through the lens of history. It's quite another to watch it happen form your living room"

– Simon Black

Of Note

Our economy is a process with lots of variables. You could throw a dart and pick any variable to monitor: CPI, GDP, the money supply, the price of equities, the price of commodities, or even things like average number of potato chips contained in a $0.99 bag. Just like the economy consists of trillions of transactions taking place every day, there are similarly an endless number of variables that one could monitor to try and forecast the health of our financial closed loop process.

Two recent variables worthy of review were (1) another regional bank collapsing, and being put into receivership and (2) the price of equities continuing to move higher as though nothing is wrong. Each of these effects had their causes: the bank collapsed because, like Silicon Valley Bank, it lost confidence when it announced it would likely need to sell billions in assets, and the price of equities moved higher because of skewed behavioral market psychology that's a residual effect of 15 years of horrifically arrogant monetary policy and easy money policies.

The juxtaposition of these two variables — the fact that markets didn't care and/or notice that another bank had just collapsed — is difficult to overlook. It's especially difficult when put into context. Since March, five major banks have collapsed: Silicon Valley, Silvergate, Signature Bank, Credit Suisse and now First Republic.

The stock market isn't the economy, and one can move without affecting the other, but this odd relationship between equity markets and economic reality just seems like an insult to the natural laws of economics and free markets. The Credit Default Swap (CDS) market seems to understand this. Recall a CDS is the most highly utilized type of credit derivative. In its most basic terms, a CDS is similar to an insurance contract, providing the buyer with protection against specific risks. Most often, investors buy credit default swaps for protection against a default, but these flexible instruments can be used in many ways to customize exposure to the credit market. It can be used as a measure of sovereign risk, as shown at this link:

[1YR EUR CDS]

There are many economic "blow off valves" that can bear the reality of the economic disaster that is unfolding, and that equity prices seem to be elude, meaning equity prices could remain high, but something else is going to have to give if that's going to be the case. Take a look out there and you can find a case for pretty much any story you want to tell yourself. There's analysts saying gold will go to $8,000, there's analysts saying oil could go to $300, there's analysts saying the Dow Jones will go to 50,000, there's analysts saying copper is going to 20x and there's analysts saying the bond market will crack up in the face of yield curve control.

If interest rates and equity prices were the only two economic variables in the entire macro system, the market would be down 80% off its highs by now, at least. But they're not. Instead, we have to contend with things like the money supply and market psychology, not to mention commodities, Fed bond buying (and selling), and numerous other "wild cards". This never-ending list of things we must contend with also means there is a never-ending list of alternate items where the turmoil that should be showing up in equity markets will be diverted to.

Right now, the Federal Reserve is the person at the party who is so drunk, they're the only one that thinks they're in control. The rest of the party is just looking on in horror and embarrassment. It is beyond disturbing that the government right now is bailing out banks left and right, with a ho hum attitude, as if it's no big deal. That attitude has grown on the Treasury Secretary and Fed like a mold, left over from the damp blanket of hubris-laden monetary policy we draped the economy with over the last 15 years.

Remember in 2008 when we actually had to have a debate about whether or not to bail out the global economic system because of — oh, you know, moral hazard and the general idea that maybe we don't want to walk a path that could lead to the collapse of our currency?

That bailout set a nasty precedent. If we were faced with the same type of decision to make today, it would be signed, sealed, delivered and finished with Powell and Yellen smiling as though they saved the world, in under an hour. There is no moral hazard debate. There is no U.S. dollar debate. There is no debate about abusing our “privilege” of being able to print money. There’s no debate at all. Bailouts and printing are simply an assumption now. Like Caesar, we may now be in for massive consequences for crossing a small rubicon.

As an investor, this setup continues to point toward owning gold and miners. As confidence erodes in the sanctity of the U.S. as global reserve currency, these assets could flourish. And even if the dollar holds up as reserve currency, it's not clear how it can be taken seriously for much longer. The BRICS nations are mounting a challenge and when the world is ultimately forced to choose between a debt based U.S. system and a commodity/gold backed BRICS system, the choice is going to be obvious. When the dollar becomes the “fix all” for the U.S. economy in coming quarters — for markets crashing, banks collapsing and, eventually, the bond market failing — precious metals will officially become the blowoff valve.

And if the abuse of the dollar was the only thing we had to worry about, that would be one thing. But it isn’t — this lackadaisical attitude about simply bailing out whoever needs it, at any time, with no limits — comes at a time when the rest of the world is openly challenging the U.S. dollar in a way they never have before. The impetus for this challenge, as I have noted before, was the seizing of Russian reserves and weaponizing the U.S. dollar.

Guys like Brent Johnson may wind up being right: the dollar may survive as global reserve currency, and it may even wind up maintaining its value against a basket of other DXY currencies. But given the unique and precarious nature of the global economy and the fact that BRICS nations are all but guaranteed to start their own commodity/gold based system, means that the dollar will for certain depreciate against gold.[6]

Footnotes and Sources

1. The Wall Street Journal, May 5, 2023
2. The Wall Street Journal, May 5, 2023
3. The Wall Street Journal, May 5, 2023
4. The Wall Street Journal, May 3, 2023.
5. CMEGroup.com, May 3, 2023
6. zerohedge.com/markets/economy-powder-keg-boiling-over-and-ready-blow

revision without notice.

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The Dow Jones Industrial Average is an unmanaged index that is generally considered representative of large-capitalization companies on the U.S. stock market. Nasdaq Composite is an index of the common stocks and similar securities listed on the NASDAQ stock market and is considered a broad indicator of the performance of technology and growth companies. The MSCI EAFE Index was created by Morgan Stanley Capital International (MSCI) and serves as a benchmark of the performance of major international equity markets, as represented by 21 major MSCI indexes from Europe, Australia, and Southeast Asia. The S&P 500 Composite Index is an unmanaged group of securities that are considered to be representative of the stock market in general.

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