WEEK IN PERSPECTIVE

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Waning faith in central banks leads to continued de-risking from stocks

Central banks were at the center of this week's trading action, and judging by the stock market's weakness, the central banks were anything but supportive.

On the contrary, the stock market broke down because faith in the Federal Reserve -- and other central banks -- in being able to skirt a recession also broke down.

The breakage, though, had to do with more than just the rate-hike actions from the central banks. It also had to do with liquidity concerns that rocked the cryptocurrency market, earnings concerns that gripped the entire stock market, growth concerns that undercut many commodity prices and drove junk bond spreads to their widest since November 2000, and excessive volatility in the Treasury market that rattled investor confidence.

The week began on an unnerving note with cryptocurrency prices coming undone on the news that crypto lender Celsius had suspended customer withdrawals and transfers. That drove some panicky selling and fueled angst about forced selling to meet margin calls that persisted all week. Bitcoin started the week just above $25,000.00. As of this writing, it was just above $20,000.00.

There wasn't any place to hide this week, except perhaps the U.S. dollar. The U.S. Dollar Index jumped 0.5% to 104.67. Otherwise, losses were registered in stocks, bonds, cryptocurrencies, and commodities as recession fears spread far and wide.

Briefly, the S&P 500 slumped 5.8%; the 2-yr note yield jumped 14 basis points to 3.18% after moving as high as 3.43% earlier in the week; the 10-yr note yield increased eight basis points to 3.24% after kissing 3.50% earlier in the week; oil prices dropped 10.1% to $108.46/bbl; natural gas prices plummeted 20.8% to $7.02/mmbtu; and copper futures fell 6.4% to $4.02/lb.

All 11 S&P 500 sectors lost ground with declines ranging from 4.4% (consumer staples) to 17.2% (energy). The Dow Jones Industrial Average fell below 30,000, and each of the major indices set new 52-week lows.

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The energy sector, which was -- and still is -- the best-performing sector this year (+31.4%), was arguably the benchmark for the recession trade that dominated the stock market. It broke down on momentum-driven selling interest that was precipitated by concerns about a major slowdown in global demand in coming months as world economies feel the pinch of rapidly rising interest rates.

The Federal Reserve was the focal point, ending a two-day meeting on Wednesday with a decision to raise the target range for the fed funds rate by 75 basis points to 1.50-1.75% and offering updated projections that showed a downward revision to 2022 real GDP growth (to 1.7% from 2.8%), an upward revision to 2022 PCE price inflation (to 5.2% from 4.3%), a stark adjustment in the median estimate for the fed funds rate in 2022 (to 3.4% from 1.9%), and a median estimate placing the Fed's terminal rate at 3.8%.

Fed Chair Powell added at his press conference that the July meeting will likely feature either a 50-basis point or 75-basis point rate hike. He also expressed a commitment to getting inflation under control, but, importantly, he created a sense of uncertainty as to whether 3.8% will ultimately be the terminal rate.

The Swiss National Bank, meanwhile, followed hot on the heels of the Fed with a surprise 50-basis point rate (its first rate hike in 15 years) that matched a similar rate hike from Brazil's central bank. The Bank of England raised its key lending rate by another 25 basis points, as expected, but downgraded its Q2 GDP forecast to -0.3% as a whole. The latter forecast was heard in conjunction with a report that the Atlanta Fed's GDPNow model estimates no growth in real GDP in Q2 versus a prior projection for 0.9% growth.

The Bank of Japan for its part continued to play the role of outlier. It left its key policy rate unchanged at -0.1% and maintained a commitment to yield curve control with an aim of keeping the 10-yr JGB yield around zero percent. That decision didn't sit well in the forex market. The yen fell 2.1% against the dollar on Friday to 134.96.

Separately, the ECB held an emergency meeting on Wednesday to develop a plan to mitigate the bond fragmentation issues afflicting confidence in the eurozone's outlook.

In sum, there were widespread worries about the current policy approaches being pursued by the central banks. The fear of a policy mistake was wrapped up in all of them. The principal driver, though, boiled down to growth concerns that revolved around stagflation and recession.

Neither outcome would bode well for the earnings prospects for most companies, which is why most stocks fell prone to further selling interest this week. Effectively, there was a loss of faith in current earnings estimates that went hand-in-hand with the waning faith in central banks to control inflation without inviting a recession.

Accordingly, the de-risking from stocks continued to be the default position.

- Dow Jones Industrial Average: -17.7% YTD
- S&P 400: -21.9% YTD
- S&P 500: -22.9% YTD
- Russell 2000: -25.8% YTD
- Nasdaq Composite: -31.0% YTD

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