



**Economy:** U.S. Economy is facing significant Inflationary Pressures. The Core Consumer Price Index (CPI) is at 5.7% currently and the Personal Consumption Expenditure (PCE) is at 5.3%. These are among a list of key parameters monitored by the U.S. Federal Reserve (FED). Inflation has come down from the 8%+ level to the current levels, but still a long way to go to reach the FED target level of 2%. Key components that need to be controlled for inflation are: Goods, Housing, and Service prices. Goods prices have come down significantly, thanks to lower Energy prices and removal of some bottlenecks in the supply chain. Housing: Real estate prices have stalled and the new leases are renewed at a lower rent, so eventually housing price reduction will be reflected in lowered inflation. Due to very low unemployment of 3.4%, the services sector of the economy is very strong and these prices have not come down and pose a significant challenge for the FED. It has raised interest rates from 0-.25% to 4.75%-5% within 1 year. It will still need to raise rates and keep them higher for longer per FED Chairman Jerome Powell's recent testimony to Congress. This will allow them to gradually bring the inflation down. But this will also take the U.S. Economy towards a significant slowdown or a recession.

**Silicon Valley Bank (SVB) Collapse:** SVB served many Silicon Valley and Venture funded firms and startups. The bank had a mismatch of Long-Term Treasury Bond investments vs. Short Term Deposits from their customers. Due to the significant increase in Interest Rates, their long-term treasury bond prices fell significantly and resulted in large losses. They did not liquidate these positions fast enough and have enough short-term capital to provide for their customers' short-term deposits. When they announced a stock sale to generate additional capital, the Venture backed firms started to see higher risk and started withdrawing significant funds from the bank. This caused the "Run of the bank" and SVB was out of cash to provide to customers by Friday. FDIC took over the bank on Friday. The U.S. Treasury, FED, and FDIC just announced Emergency measures to protect the Bank Depositors and allow them to withdraw funds starting tomorrow. The FED also announced that it would offer loans of up to one year to meet the banks needs in exchange of treasury securities to allow banks to serve their depositors. This will be a significant help for Small Venture bank firms, startups, and SVB depositors, and also prevent a larger contagion to the economy.

**Market:** Stock markets reacted sharply in response to FED raising the interest rates. S&P 500 had returns of -19% and Nasdaq had returns of -30% in 2022. Crypto currency investments were also largely impacted due to the collapse of FTX and Silvergate as well as risk-off investment preference. The large investment institutions are factoring in the effect of Interest rate hike as the Company Earnings are now discounted at much higher discount rate of 5% or higher depending on the firm. The S&P 500 P/E ratio has dropped from about 34 to 20. The forward P/Es have also dropped significantly and thus you saw a precipitous drop in stock prices. As we are in



the Late slow down phase of the economic cycle, defensive sectors perform relatively better compared to the high-risk tech names. Our managed accounts had seen a draw down, but much less than S&P500 and Nasdaq due a higher cash position, diversified investments, dividends, and protective option positions.

**Looking forward:** Markets recovered a bit in 2023, but have again corrected in anticipation of higher interest rates. We are keeping a close eye on inflation and on the Federal Reserve rate increases and forward earnings estimates of the companies during the earnings season. We will manage the portfolios to reduce the volatility and invest in fundamentally strong companies and diversify with ETFs. A dollar-cost averaging approach will help us reduce our overall costs, while gradually participating in the market.

## References:

- U.S. Bureau of Economic Analysis: <https://www.bea.gov/data/gdp/gross-domestic-product>
- Trading Economics: <https://tradingeconomics.com/united-states/inflation-cpi>
- Bob Brinker's Market timer. March, 2022. <http://bobbrinker.com/>