First Trust Portfolios Canada
Monday Morning OUTLOOK

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Ignore the Crazy

While many investors are focused on the financial troubles affecting Silicon Valley Bank (SVB) and whether those troubles will spread, there were two other major issues that hit the markets last week: the Biden budget and Fed Chief Powell hinting at raising rates by a half a percentage point rather than a quarter.

It shouldn't be any wonder why investors are worried about the Biden budget proposal, which includes a murderer's row of growth-destroying tax hikes. The top tax rate on capital gains and dividends would go to 44.6% versus a current 23.8% (almost double!), the top tax rate on regular income would go to 44.0%. Taxes would go up on S Corporations, small business income, and interest income. The corporate tax rate would jump to 28%; the stock buyback tax would go to 4% versus 1%.

If this proposal were passed by Congress, it would hammer the economy and the stock market. Thankfully, we believe the odds of these proposals making it into law are very slim to none.

Think about it. Nothing was stopping President Biden from making these proposals last year or the year before. Why didn't he? Because he knew some Democrats would object, making them impossible to pass and undermining party unity. But now that Republicans control the House the Administration can pursue extreme tax hikes secure in the knowledge the plan won't pass (and cause economic damage) while the House majority party takes the lead opposing the proposals.

As for the prospects of the Federal Reserve raising rates by half a percentage point next week, we think Powell would only open the door to that possibility if it were his intention to go through that door. However, the news about SVB, news that Powell didn't have before his testimony last week, now makes a 50 basis point hike unlikely.

The bottom line is that in spite of investors and markets obsessing about rate hikes they need to focus on the money supply. The supply of money exploded in 2020-21 but peaked in early 2022 and has since declined at the fastest pace since the 1930s. It's the growth in the money supply, or continued lack thereof, that will determine what happens to economic growth and inflation in the next couple of years. Obsessing about the short-term interest rates targeted by the Fed, when there is no real market for federal funds traded among banks anymore, is barking up the wrong monetary tree.

Financial markets are on tenterhooks right now. But SVB is not a *systematically* important bank that will, through counter-party risk, tear down the whole financial system. Instead, it's *symptomatically* important, showing what happens when the Fed ignores Milton Friedman and the money supply and then claims inflation is transient when it isn't. SVB's managers made a huge mistake by not hedging its assets' interest-rate risk. But it's a mistake they were seduced into making by bad monetary policy that was too loose for too long.

Expect more trouble ahead, that's why we have been bearish on equities and the economy. But, without strict mark-to-market accounting in place, don't expect a meltdown like 2008-09.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
3-14 / 7:30 am	CPI – Feb	+0.4%	**+0.4%**		+0.5%
7:30 pm	"Core" CPI – Feb	+0.4%	**+0.4%**		+0.4%
3-15 / 7:30 am	Retail Sales – Feb	-0.3%	**-0.1%**		+3.0%
7:30 pm	Retail Sales Ex-Auto – Feb	-0.1%	**+0.1%**		+2.3%
7:30 am	PPI – Feb	+0.3%	**+0.3%**		+0.7%
7:30 am	"Core" PPI – Feb	+0.4%	**+0.4%**		+0.5%
7:30 am	Empire State Mfg Survey – Mar	-8.0	**-9.3**		-5.8
9:00 am	Business Inventories – Jan	0.0%	**-0.1%**		+0.3%
3-16 / 7:30 am	Initial Claims – Mar 11	205K	**205K**		221K
7:30 am	Housing Starts – Feb	1.310 Mil	**1.330 Mil**		1.309 Mil
7:30 am	Philly Fed Survey – Mar	-15.0	**-12.8**		-24.3
7:30 am	Import Prices – Feb	-0.2%	**0.0%**		-0.2%
7:30 am	Export Prices – Feb	-0.3%	**+0.2%**		+0.8%
3-17 / 8:15 am	Industrial Production – Feb	+0.2%	**+0.6%**		0.0%
8:15 am	Capacity Utilization – Feb	78.4%	**78.7%**		78.3%
9:00 am	U. Mich Consumer Sentiment- Feb	67.0	**67.0**		67.0