Amplify ETFs

Market and Economic **Update**

Three Charts on Markets and Financial Stability in Q2

APRIL 2023

In times of market uncertainty, investors often turn to sayings such as “those who fail to learn from history are doomed to repeat it” and “history never repeats itself, but it does often rhyme.” When it comes to the day-to-day headlines, both quotes are relevant given the long history of banking crises and market swings.

This is because investors must deal with innumerable challenges over the course of their financial lives. In the last few years, portfolios and financial plans have been tested by the pandemic, the highest inflation rates since the 1980s, global conflicts, political uncertainty, asset bubbles, swiftly shifting monetary policy, and much more. Even when times are otherwise calm and markets are steadily rising, including from 2009 to 2020, investors and the media always find reasons to be worried. While it may be important to understand the individual issues, it is perhaps more important to maintain a broader perspective based on the lessons of history.

Of the various challenges investors face today, the banking crisis is perhaps the biggest unforeseen event. It’s now clear that FDIC-insured banks hold bonds that are worth hundreds of billions less due to rising interest rates. Banks such as Silicon Valley Bank and Signature Bank had customers concentrated in specific industries, such as tech and crypto, that made them susceptible to liquidity problems and bank runs. In Europe, Credit Suisse may have had strong capital and liquidity ratios, but ongoing problems made it susceptible to a bank run. Fortunately, the situation has stabilized over the past few weeks.

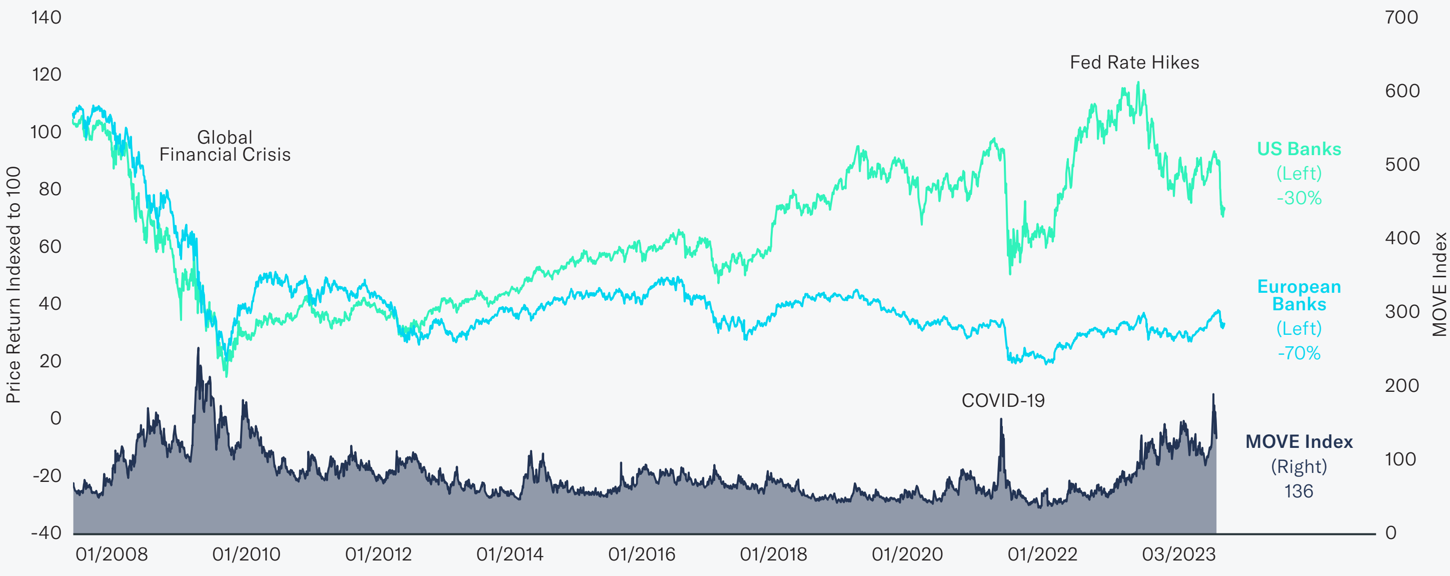
While there are always reasons to be on the edge of one’s seat, there are also reasons for optimism. The market, economy, and the financial system have been far more resilient in 2023 than many expected. The job market has been surprisingly strong despite layoffs in tech. Inflation has improved markedly across key areas such as energy and goods. Interest rates rose swiftly early in 2021 and throughout 2022 but have stabilized more recently with the 10-year Treasury yield ending the first quarter at 3.47%. Even the stock market has improved with the S&P 500 Index having gained 7.6% and 7.5% across the last two quarters.

Below, we highlight three important insights to guide investors through the coming months.

1. Regional bank stocks have struggled as financial conditions have tightened

U.S. vs EUROPEAN BANK PERFORMANCE

S&P 500 Banks Industry Group, MSCI Europe Banks Index, and the ICE BofA MOVE Index of U.S. Treasury market volatility. Returns are relative to January 1, 2007.



Sources: Clearnomics, MSCI, Standard & Poor’s, ICE, January 1, 2007 to March 31, 2023. Past performance is no guarantee of future results.

It's no surprise that bank stocks have struggled across markets. In the U.S., this is due to regional banks as the crisis that began with Silicon Valley Bank and Signature Bank plays out. The FDIC, Treasury Department, and the Federal Reserve (Fed) have stepped in to stabilize the system, as have their European counterparts.

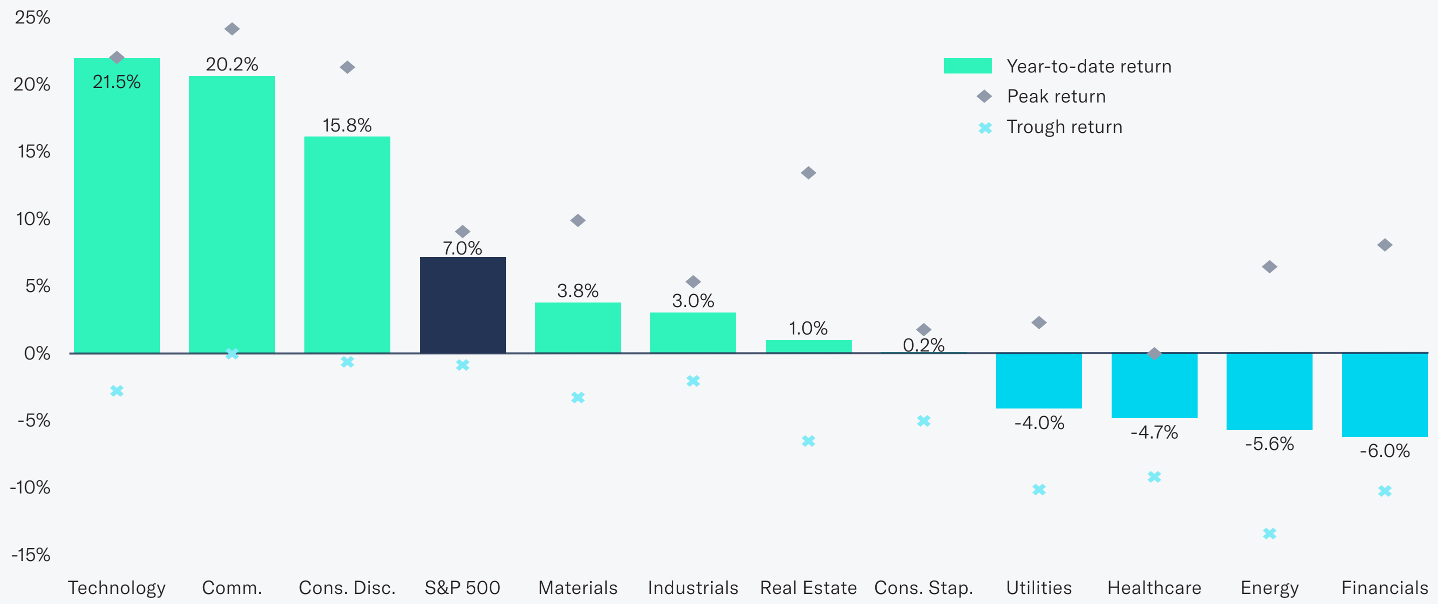
The accompanying chart shows the performance of U.S. and European banks. Perhaps most striking, however, is that the MOVE Index of bond market volatility jumped to its highest level since the 2008 financial crisis. Fortunately, the situation has stabilized as the initial bank run has calmed. Ironically, this has allowed interest rates to fall which will likely reduce the unrealized bond losses at banks that helped create this situation in the first place.

While there are specific circumstances underlying each of these bank failures, financial instability tends to occur when monetary policy and credit conditions tighten. This is partly because many banks have grown accustomed to high levels of liquidity supporting deposits and their aggressive customer acquisition practices. Thus, it will take time for the banking system to stabilize as the world adjusts to tighter financial conditions.

2. Financials have struggled but tech-related sectors have rebounded

SECTOR-RETURNS — YEAR-TO-DATE

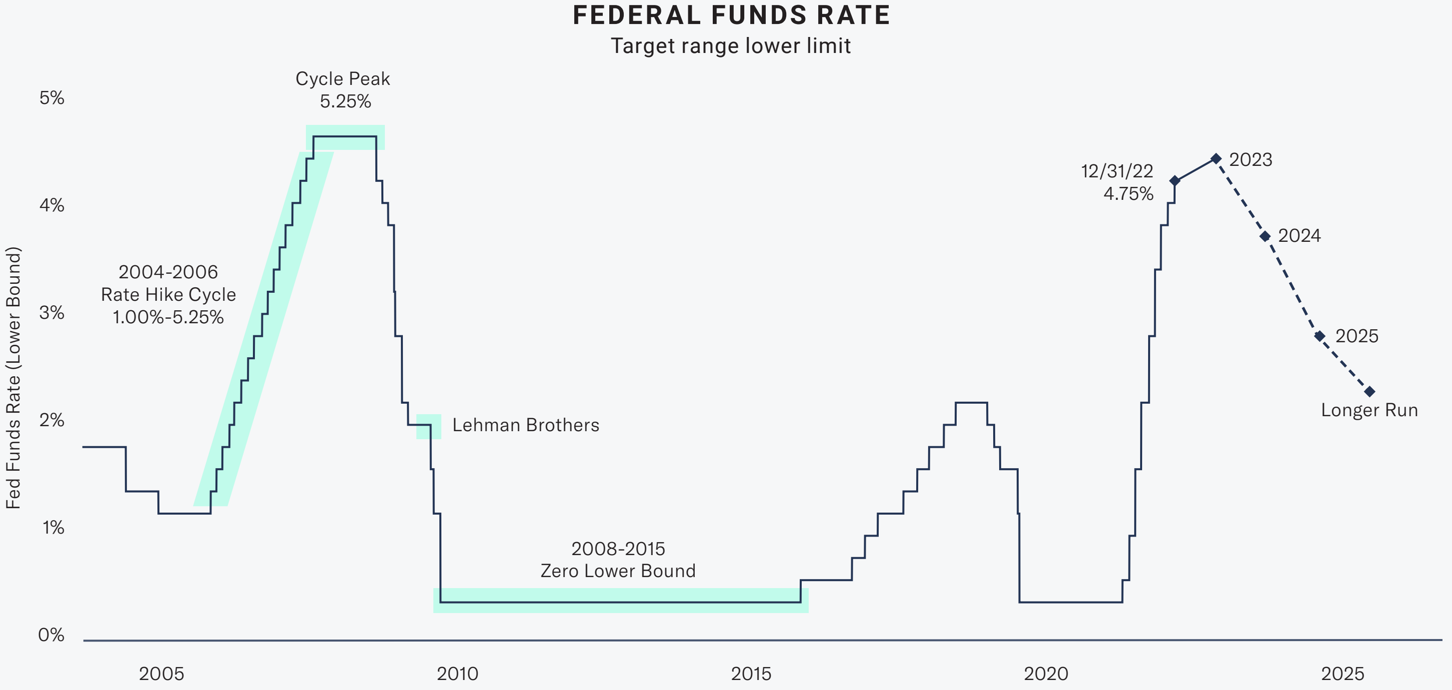
S&P 500 sector year-to-date, peak and trough returns



Sources: Clearnomics, Standard & Poor's, Refinitiv, January 1, 1980 to March 31, 2023. Past performance is no guarantee of future results.

While the S&P 500 Financials sector has struggled due to financial stability concerns, many other sectors have offset it. The Information Technology, Communication Services and Consumer Discretionary sectors have rebounded from last year's losses as interest rates have fallen and the economy has grown more resiliently than expected. Similarly, the Nasdaq gained 17% with dividends in the first quarter. While investors should not focus too much on only three months of returns, this is a reminder of how quickly market sentiment can shift and of the importance of staying diversified across sectors.

3. The Fed is expected to slow its pace of rate hikes or to cut rates



Sources: Clearnomics, Federal Reserve, January 2002 to present. Federal Funds Rate after April 3, 2023 are estimated projections. The Federal Open Market Committee (FOMC) decides on a target range for the federal funds rate at each meeting. The lower bound represents the bottom end of that range.

The Fed chose to raise rates despite the ongoing banking crisis, in part as a message about their confidence in the financial system. The Fed's latest projections show that officials expect to keep rates high through the rest of 2023. This is in stark contrast with fed funds futures which show implied rate cuts later this year. Either way, this suggests that the Fed is near the end of its rate hike cycle after one of the sharpest jumps in policy rates in history.

Ultimately, investors should focus on the long run and not overreact to daily headlines. While there are ongoing challenges, this is always the case for investors. Staying focused and holding diversified portfolios is still the best way to achieve long-term financial goals.