What's Hot: Inflation dominates financial stability risks for central banks

Published March 24, 2023

Aneeka Gupta
Director, Macroeconomic Research

Despite the banking industry turmoil, central banks continued to raise rates last week. This marked moves from the European Central Bank (ECB) by 50Bps, Federal Reserve (Fed) by 25Bps, Bank of England by 25Bps, Swiss National Bank by 50Bps, Norway by 25Bps, the Philippines by 25Bps, and Taiwan by 12.5Bps. Central banks appear determined to show they have the tools in place to nip financial stability issues in the bud and so monetary policy is free to deal with inflation.

The Fed is likely nearly done

The March Federal Open Market Committee (FOMC) turned out to be on the dovish side. This was evident in the written statement in which the FOMC anticipates – “some additional policy firming may be appropriate” from “ongoing increases in the target range will be appropriate”. There was a risk that if the Fed chose not to hike rates, it would raise concerns about further financial system weakness. The reason given was that financial instability was "likely to result in tighter credit conditions for households and businesses and to weigh on economic activity, hiring, and inflation”.

The Fed has clearly signalled to the markets that it can control financial contagion from spreading by providing large amounts of liquidity. Over the past weeks we have seen a combination of measures to stabilise the market turmoil, including 1) The Fed’s proposal to provide immediate deposit protection and emergency lending 2) the intervention by Swiss Authorities to merge Switzerland’s two biggest banks and 3) the resumption of a dollar swap facility among central banks.

If the banking crisis calms down and the economic data looks anything similar to the January/February reports, another rate hike at the May FOMC meeting should not be ruled out. Conversely, ongoing market dislocations could outweigh the data and push the Fed into pause mode. Currently the implied probability for Fed Funds Futures looks for a rate cut during the summer. That scenario can only materialise if the risks emanating from the banking system continue to deteriorate from a market and/or economic perspective.

Gold offers a potential investment solution

There is no doubt that the investment landscape is fraught with elevated uncertainty and, of course, the volatility that comes with it. Gold is benefitting twofold from its safe haven status alongside the earlier than expected pivot in monetary policy by the Fed. While the Fed does not currently see rate cuts this year, in contrast to market expectations, its projections raise the prospect of rate cuts for 2024 which remains price supportive for gold.

The Commodity Futures Trading Commission (CFTC) has now largely caught up with publishing futures positioning data for gold following the disruption in February due to a ransomware attack on ION Trading. We now know there was a slump in positioning during February, but net longs in gold futures rose back above 154k contracts on 14 March 2023 as the banking crisis was unfolding.

Source: Commodity Futures Trading Commission (CFTC), WisdomTree from 14 March 2018 to 14 March 2023. Please note: Stdv – Standard deviation is a measure of the amount of variation or dispersion of a set of values.

Historical performance is not an indication of future performance and any investments may go down in value.

Laying an emphasis on quality stocks

Rising concerns about financial stability tends to cause negative feedback on the real economy. Quality has stood the test of time, displaying the steadiest outperformance over 10-year periods. Dating back to the 1970s, quality has displayed the highest percentage 89% of outperforming periods in comparison to other well-known factors.

Sources: WisdomTree, Ken French, data as of 31 January 2023 and represents the latest date of available data. Value: High 30% Book to Price portfolio. Size: Low 30% portfolio. Quality: High 30% portfolio. Low Vol: Low 20% portfolio. High Div: High 30 portfolio. Market: all CRSP firms incorporated in the U.S. and listed on the NYSE, AMEX or NASDAQ.

Historical performance is not an indication of future performance and any investments may go down in value.

The WisdomTree Global Developed Quality Dividend Index (Ticker: WTDDGTR Index) offers investors an exposure to dividend paying stocks in developed markets with a quality tilt. The WisdomTree Global Developed Quality Dividend Index has outperformed the MSCI World Index (Ticker: MXWO Index) by 1.54% over the past five years. The emphasis on quality, by tilting the portfolio exposure to stocks with a high return on equity has played an important role in its outperformance versus the benchmark.

Source: WisdomTree, FactSet, Data as of 28 February 2023.

Historical performance is not an indication of future performance and any investments may go down in value.

Over the past five years, we also observed the allocation and selection of stocks within the information technology, financial and healthcare sectors contributed meaningfully to the 1.54% outperformance versus the MSCI World Index as highlighted below.

Source: WisdomTree, FactSet, Data as of 28 February 2023. Historical performance is not an indication of future performance and any investments may go down in value.

Important Risks Related to this Article

Important Information

Marketing communications issued in the European Economic Area ("EEA"): This document has been issued and approved by WisdomTree Ireland Limited, which is authorised and regulated by the Central Bank of Ireland.

Marketing communications issued in jurisdictions outside of the EEA: This document has been issued and approved by WisdomTree UK Limited, which is authorised and regulated by the United Kingdom Financial Conduct Authority.

WisdomTree Ireland Limited and WisdomTree UK Limited are each referred to as "WisdomTree" (as applicable). Our Conflicts of Interest Policy and Inventory are available on request.

For professional clients only. The information contained in this document is for your general information only and is neither an offer for sale nor a solicitation of an offer to buy securities or shares. This document should not be used as the basis for any investment decision. Investments may go up or down in value and you may lose some or all of the amount invested. Past performance is not necessarily a guide to future performance. Any decision to invest should be based on the information contained in the appropriate prospectus and affer seeking independent investment, tax and legal advice.

The application of regulations and tax laws can offen lead to a number of different interpretations. Any views or opinions expressed in this communication represent the views of WisdomTree and should not be construed as regulatory, tax or legal advice. WisdomTree makes no warranty or representation as to the accuracy of any of the views or opinions expressed in this communication. Any decision to invest should be based on the information contained in the appropriate prospectus and affer seeking independent investment, tax and legal advice.

This document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public offering of shares or securities in the United States or any province or territory thereof. Neither this document nor any copy hereof should be taken, transmitted or distributed (directly or indirectly) into the United States.

Although WisdomTree endeavours to ensure the accuracy of the content in this document, WisdomTree does not warrant or guarantee its accuracy or correctness. Where WisdomTree has expressed its own opinions related to product or market activity, these views may change. Neither WisdomTree, nor any affiliate, nor any of their respective officers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or its contents.