Weekly Market Summary

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What Follows Market Capitulation?? Only God Knows Really!!

Fadi Nasser - Deputy Chief Investment & Treasury Officer

Latest Update on Coronavirus: Confirmed cases last at 253,925 (versus 136,388 last Friday), 10,406 deaths (versus 4,995). The COVID-19 is now affecting 182 countries and territories around the world (versus 129 last week). Compiled statistics keep sending a worrying signal: It took three months for the first 100,000 cases, but only 12 days for the next 100,000! California Governor, Gavin Newson, has just ordered the state's 40 million residents to "*stay at home*", with predictions running high that 56% of the state's population will be infected over the next eight weeks. Social distancing is exerting major stress on governments' revenues at a time emergency expenses and bailout funds are poised to surge; Fiscal stimulus will come back with a vengeance in the US (size of the debated package in Congress expected to swell considerably past the $ 1 trillion mark), whilst the German government wants to set up a EUR 500 billion rescue fund for firms (a trillion+ here, 500 billion there … who's really counting?) The virus drug hyped by the US President as a possible line of treatment against the coronavirus has shown encouraging results in clinical trials, though comes with severe warnings as it potentially displays lethal side effects (Chinese doctors believe it can kill in dosages as little as 2 grams!) 2020 exams for students are expected to be cancelled in various countries, though grading will still take place to enable everyone progress in their education, especially for those going on to university or into work!

One of the worst myths out there is that financial markets are always rational and makes sense; That is surely NOT true! The other one is that many investors pretend to fully understand market moves: If that is the case and you have a really good theory about why stocks and bonds sold in tandem earlier this week or why LIBORs (London Interbank Offered Rates) inched higher at a time the US Federal Reserve had just surprised markets with a gigantic 100 bps emergency cut in its overnight Fed funds rate, then line up next to everyone else who has a really good theory! On any given day or week, the market can make seemingly random moves for reasons that do not make sense: Sometimes bonds go down when they should have gone up, and sometimes entire equity sectors move in one direction or the other for ridiculous reasons! Never assume that just because something happened, it has to make sense because the market is always supposed to make sense; That is simply NONSENSE! The key is to understand the catalysts that make assets move: If a move has nothing to do with the underlying prospects of the financial instrument you are tracking, then take advantage of that irrationality, not buying into it by chasing it higher or panicking out of it at depressed levels (a la Warren Buffet's mantra: "Be fearful when others are greedy and greedy when others are fearful!"). Additionally, here is a dirty secret about financial markets: Much of the time, nobody has any earthly idea why stocks/bonds/commodities rise or fall on any given hour or day. The trouble is that many strategists/economists are paid to explain such phenomena, and so they often resort to that mysterious analytical technique known as "*guessing*."

Despite aggressive policy loosening by the US Federal Reserve, the European Central Bank (ECB), the Reserve Bank of Australia (RBA), the Central bank of Norway (Norges Bank) and others in recent days - in a world where almost every central bank tries pulling whatever levers they have left to support growth - markets witnessed indiscriminate selling in every major asset class earlier this week, in an increasingly desperate race for cash (& toilet paper for the insane crowds 😊). And whilst the never-ending sell-off in equity markets is surely a nerve-wracking experience to all market investors, it was more the chaos and lack of liquidity in markets - that might remain for an extended period of time - that was now terrifying government and monetary policy officials! After all, central bankers' provision of abundant liquidity, large-scale asset purchases and provision of term credit in various forms was administered to help unclog dealer balance sheets and improve market functioning in a quick way.

Instead, a massive dislocation across asset classes was taking place, causing a full breakdown in traditional relationships/asset correlations and causing funds billions of dollars in losses (when bonds, stocks and even gold – a hedge against the prospect of central banks' helicopter money – all fall at once, you know that your historical global macro trends and latest computer algorithm models are all failing and hurting!) Take for example the risk parity trade, which bets on a near-perfect match between stock rallies and bond sell-offs - and had worked out quite well for the past decade. As of early March, the weekly correlation between the S&P 500 and 10-year Treasury bonds was -0.84. A score of minus 1 would mean there is perfect negative correlation, i.e. when stocks rise, bonds would always fall. But the coronavirus shook that landscape: The yield on 10-year Treasuries had tripled in recent days, from a low of 0.40% on March 9th to a high of 1.25% last Wednesday evening, even as the Federal Reserve had slashed its benchmark rate to zero (the same phenomena was also unfolding in Europe and Japan!) With stocks and bonds falling, the underlying thesis of the risk parity trade was drawn down with it. To make matters worse, these trades tend to use leverage to amplify bond exposure; With dollar funding freezing up and banks hoarding cash to buffer against market volatility and commitments, traders and analysts were fast panicking and making comparisons to the financial crisis. "*Too big to fail is back, and this time it's not the banks, it's levered financial institutions*," according to Mark Yusko, the chief executive officer of Morgan Creek Capital.

In the world of psychology, confusion is a symptom that makes people doubt their ability to think clearly and leave them disoriented and unable to express confident views. At times, it is referred to as disorientation, but in its extreme state it is known as delirium! (Trump's increasingly frequent practice of calling the coronavirus the "*Chinese Virus*", whilst ignoring a growing chorus of criticism that it is racist/can't be but interpreted as xenophobic and will further ratchet up tensions between the two superpowers, would surely qualify him for the latter 😊). With fears growing over the psychological and economic impact of the spreading illness, investors' nerves are now on full display! But who could blame them? Daily breaking news headlines remain troubling to say the least: The number of confirmed cases is fast mounting and spreading to new jurisdictions (latest numbers include in excess of 10,000 deaths and close to 250,000 cases!), flights are being cancelled, schools and universities are closings, non-essential businesses like cinema, gyms, clubs, bars and restaurants are shut, lockdowns have become commonplace and more companies are asking employees to work from home (or relax at home 😊) whenever possible! Additionally, most economists have now turned more pessimistic over the chances of a speedy recovery (V-shaped) as evidence mounts that the disruption will be deeper and more long-lasting than first thought and as factories and business struggle to re-open amid curbs on movement. The world economy's gross domestic product will slow "*effectively to zero*" this year (versus a weakfish 2.9% last year), matching the major downturns of 1982 and 2009, Ethan Harris, head of global economic research at Bank of America Securities Inc, wrote in a report to clients yesterday. "*The evolving news on COVID-19 has triggered 'forecast leap frogging,' with economists and strategists repeatedly lowering their forecasts*," he added. "*Here we take a big leap, as we try to make our forecast robust to the near-term news flow*." By comparison, the Morgan Stanley's team now believe that a worldwide recession is its "*base case*," with growth expected to fall to 0.9% this year, though Goldman Sachs Group Inc. only predicts a weakening of growth to 1.25%.

Over the past 48 hours, global markets have managed to breathe a little after major central banks once again took out the big guns; The Federal Reserve revived a few emergency lending facilities put to sleep after the global financial crisis, and established currency swap lines with emerging markets such as Brazil and Mexico, whilst the ECB's latest package of asset purchases was equally cheered by investors. Also U.S. investment-grade borrowers gave the primary market another shot of life yesterday, bringing five new deals on top of four in Europe. Add to that, more stability in equity markets and a late surge in oil prices (the biggest daily jump - percentage wise - since 2008 as Middle) after the U.S. President suggested he would get involved in the oil price standoff at the "*appropriate time*." "*It's very devastating to Russia, because the whole economy is based on that, and they have the lowest prices in decades*," Trump said. "*I would say it's very bad*

for Saudi Arabia. But they're in a fight, they're in a fight on price, they're in a fight on output. At the appropriate time I'll get involved." (as soon as I am done filling that Beautiful U.S. Strategic Petroleum Reserve tank! 😊).

But will that be enough? Honestly, who knows? We had previously argued that central banks can't stop the virus; At best, they can only blunt the blow to financial markets. Though one could argue that the latest unprecedented government and central banks' measures to shield economies from the accelerating coronavirus pandemic will soon help soften the potential blow and result in risk-on trading for the stronghearted! While you don't want to count your chickens before they hatch, if equities put a second consecutive daily rally and close in the green later today, it would be the first time in five weeks that investors would see the S&P 500 gain on back-to-back days!

And to think that such small positive occurrence is now sufficient to cheer shattered market players!

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