Weekly Market Summary

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How Many More Trillions Will be Enough to Save the World Economy?? Take Your Guess!!
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Latest Update on Coronavirus: Confirmed cases last at 542,533 (versus 253,925 last Friday), 24,369 deaths (versus 10,406). The COVID-19 is now affecting 199 countries and territories around the world (versus 182 last week). Spain continues recording record numbers of daily deaths. The US Centres for Disease Control and Prevention has issued a domestic travel advisory, urging New York, New Jersey and Connecticut residents to avoid non-essential travel (after US President Trump opted against putting those hard-hit areas under quarantine). Abbot Laboratories has unveiled a coronavirus test that can tell if someone is infected in as little as five minutes and is so small and portable it can be used in almost any health-care setting!

The depth of the hole the world economy has just experienced and/or is about to fall into means climbing quickly back out will be difficult to do. Major industries from airlines to hospitality to shale oil face a wave of bankruptcies. Confronting weeks or even months without revenue, small businesses will similarly be forced to lay off workers; some will shut down. Unemployment is soon set to spiral higher globally! The risk is that the blow to income and damage to the fabric of industry and the financial system turns a short, severe, contraction into a protracted and painful recession. According to Tom Orlik, the chief economist for Bloomberg Economics, "*the pace of deterioration in expectations is breath-taking. Even so, it's important to keep in mind that -- in contrast to the Asian financial crisis, the great financial crisis, or the European sovereign debt crisis -- the coming contraction is not a reflection of underlying economic imbalances. When the outbreak is over, that means there's hope growth can get rapidly back on track*." Bloomberg Economics is forecasting a global recession in the first half of 2020 and the beginning of a recovery in the second. Surely the first part of that prediction looks rock solid, given that economic contraction has already begun in important parts of the world. As for the second, we are on shakier ground and current economic forecasts and statistics will most likely be based on guesstimates and hope, but not certainty!

To stop Armageddon from happening, what has and is still being required remains fast and far-reaching policy intervention, with a risk that policy moves in many countries will prove to be too little or too slow. Over the past three weeks, political leaders and central bankers have intervened in markets and acted at a pace that puts the 2008 financial collapse in the shade - continuously announcing fiscal support, monetary policy tweaks and innovations (PMCCF, PEPP, SMCCF, CPFF, TALF, MMLF, VRDN,… I am guessing PMCCF & SMCCF will prove to be most effective, as both packages consist of 5 letters, compared to 4 for the others 😊). After all, officials know better that their economies are on course for historic slumps, that investors are panicking, and that financial markets' plumbing needs additional and recurring support.

EUREKA! IT'S FINALLY WORKING!

On Tuesday, markets started showing some glimmers of optimism and investors began to believe that there could light at the end of the tunnel. Signs were emerging that the global liquidation rout for the history books was loosening its stranglehold across stocks, credit and funding markets. Implied volatility was moving lower and investment-grade credits were falling in the aftermath of the Federal's historic new stimulus program announced the previous day. Yesterday, US equity markets completed three consecutive days of gains as market cheered the Senate's unanimous passing of the $2.0 trillion stimulus bill, even as a record 3.28 million Americans had filed initial jobless claims (up from a small 281,000 last week) - showing the severity of the coronavirus pandemic. The Dow Jones Industrial Average has now soared 23% (or 4,309 points) from lows witnessed last Monday, entering a bull market that can hopefully persist going forward. Other pockets of the market have also reacted positively to the various central bank moves: Signs of stress in the corporate debt sector have eased, with the CDX Investment Grade index spread tightening. Bond ETFs eligible for central-bank purchases have rallied and the US dollar has retreated versus major peers.

As the week draws to an end, an unprecedented 38 central banks have now slashed interest rates, with many of them going further and activating the crisis playbook (buying bonds, intervening in currency markets and setting up emergency loan programs for banks and companies). The aim: Keep markets functioning and facilitate a recovery when life returns to normal. Additionally, the Group of Seven chiefs have also been active lately, concluding a rare teleconference with a pledge to do *"whatever is necessary*." Exactly what more that may be, the world still can't say for sure! The global economy has not looked this fragile since the Great Depression of the 1930s, according to Harvard University economist Carmen Reinhart. That was the last time the world witnessed a sustained downturn in both emerging markets and their developed-nation counterparts. "*Today is reminiscent of the 1930s*," Reinhart said in an interview on Tuesday from her home in St. Petersburg, Florida, where she relocated after Harvard pivoted to online learning. "*The slump in commodities, the crash in global trade and synchronization of recessions is more like then than any time*." Elsewhere, the International Monetary Fund ("IMF") now expects a global recession this year that will be at least as severe as the downturn during the financial crisis more than a decade ago, followed by a recovery in 2021.

DEBT SOARING!!

If there were ever a time for bond traders to be fearful of out-of-control U.S. deficits, it would have been this week. After all, the Trump administration and Congressional leaders had agreed to an unprecedented $2 trillion stimulus package to help mitigate some of the economic damage caused by the coronavirus outbreak. No one is asking "*how will we pay for it?"* The answer is obvious: piling on to the $23.62 trillion existing national debt. And yet, the world's biggest bond market rallied on the news! Benchmark 10-year and 30-year yields have fallen throughout the past few days, settling into what appear to be their new comfort zones of 0.75% and 1.30%, respectively. So, what's going on? Exactly what you would expect when a price-insensitive buyer like the Federal Reserve pledges to buy as much as necessary for the Treasury market to function normally. And believe you me! It is starting to look as if that "*whatever it takes*" number is going to be almost as huge as the fiscal stimulus package. At its current pace of buying $75 billion or more a day across treasury maturities, the US central bank would add a whopping $1.6 trillion to its balance sheet in a month. The previous record for a month was March 2011, at $120 billion. Let those last two lines sink in for a moment: The Fed is on pace to buy Treasuries in an order of magnitude 13 times greater than any other time in its history!!

With its debt soaring, the US may be entering into unprecedented and dangerous territory and hastening a reckoning it has been trying to avoid. While America pulls under this burden of debt, there is another historical measure at play: A rising debt-to-GDP ratio. This compares how much a country owes to how much it produces. In 2012, the percentage of debt to GDP passed 100%, for the first time since the Second World War, back when the country was basically one giant factory pumping out armaments and supplies. In 2019 the debt-to-GDP ratio was 107%. This means that, at the moment, the debt is greater than the economy itself. What makes this scary is that it is possible, were there to be a protracted recession due to coronavirus, that the debt-to-GDP ratio could inch closer to or even go beyond the record level seen just after the Second World War, when it topped 121%. That the US might get nearer to such a level puts the country in a potentially dangerous situation, where it just has too much debt on its back, and the debt and interest become crushing. Last year, the country paid $ 600 billion just on debt interest, nearly 9% of its total spending. Before this latest crisis, the US was projected to run out of money to sustain Social Security entitlements by 2035. A sizable recession, falling GDP, a rising debt-to-GDP ratio – all threaten to narrow that time frame, bringing the country closer to the reckoning it is been putting off for years. The US is not alone when it comes to debt; The global economy, wilting under the pandemic, will suffer, which has further negative implications for the US economy and the long-term outlook. Overall, the world is borrowing more than it is producing.

Unfortunately, it is not a coincidence that the financial system we are living is becoming more unstable with every passing day. Taxpayer money will continue flowing to the same corporations that took on record debts this past decade, mostly to conduct stock buybacks and other financial gimmickry! One would have expected these mighty corporations to have spent time rebuilding their balance sheets, restocking their acorns for winter, storing in excess reserves for lean times? They could have, YES; Alas, they DID NOT! The lure of stock market riches proved too strong to resist. And now, consider this final question: What will a deluge of fiscal stimulus accomplish in the long term? Besides plunging entire nations deeper into debt and bringing forward the end game of the great debt super cycle?!

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