Weekly Market Summary

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It Ain't Over Till It's Over!!

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What a Difference a Month Makes!

2019 was ending on a high note for financial markets and investors/traders were cheering up; Positive steps toward a U.S.- China trade deal and a light at the end of the Brexit tunnel in the last two weeks of December were assuredly projected to brighten the economic outlook for 2020, exerting upward pressure on equity and commodity prices, as well as bond yields. Indeed, if a worst-case scenario was no longer in play, global growth could improve fast, stocks could rally further, the Federal Reserve could be less inclined to ease its benchmark rate and yields in major government bond markets could have more scope to rise. At least that was the chain of reasoning that made most sense heading into the new year!

And then an "Unusual" January Kicked-In!

On January 3rd, 2020, global stocks plummeted on the news that a US airstrike had killed Iranian Maj. Gen. Qassem Soleimani the previous night. Gold approached its highest price in six years (touching an intraday high of $1,590 per ounce), oil surged (Brent rallying all the way up to $ 69.5) and Treasury bond prices jumped as investors – worried about an outright conflict between the US and Iran - fled volatile assets and feared a hit to the global oil supply. And whilst the US Defence Department referred to the attack as a step "*aimed at deterring future Iranian attack plans*", the Iranian supreme leader's response warned that "*harsh retaliation is waiting*" for the US given that the latter had crossed a "*red line*" with its latest strike. For market contrarians, the dip in US stocks was seen as a golden buying opportunity to pile on US equities, especially tech stocks, while they were getting less expensive!

Then, on January 8th, Iran responded by launching missiles at two bases where US forces were housed in Iraq. Before Tehran hit back, US President Trump had threatened to launch direct strikes on the Islamic Republic if it retaliated, threatening in an earlier tweet that he would consider taking "*disproportionate*" action. Once again, markets responded with an initial jolt of volatility and an instant switch to risk-off mode - though the initial reaction proved to be short lived; An early tweet by Donald Trump proclaiming that "*all is well*" and "*so far so good*" (I am guessing that concussion symptoms such as traumatic brain injury don't count!) after the US president and his top national security advisers met at the White House - coupled with another tweet, this time from Iran's foreign minister that his country does "*not seek escalation or war, but will defend itself against any aggression*" – reassured markets that the worst was already behind us. By the close of business on that day, oil prices and global stock markets had stabilized with US stocks even re-approaching record territory!

Later that same week, the world in general – and financial markets in particular – began focusing on the outbreak of an new kind of viral disease in China with widespread concern about risks involved, and mounting fears of an official cover-up. However, with just a handful number of patients in China's Wuhan, the capital of Hubei province, seeking medical help for pneumonia-like symptoms (mainly fever and breathing difficulties) after direct exposure to a wholesale seafood market in Wuhan (which had since been closed), the World Health Organization (WHO) felt compelled to issue a reassuring statement confirming that "*preliminary investigations conducted by the authorities have found no clear evidence [even] of limited of human-to-human transmission of the novel coronavirus identified in Wuhan*". The WHO communique also "*advises against the application of any travel or trade restrictions on China based on the information currently available on this event.*"

Yesterday - with a death toll topping the 175 mark (in addition to over 8,800 infected persons) and coronavirus fears spreading fast (6,000 passengers banned from disembarking a cruise ship as tests are carried on two Chinese passengers who suffered fever and breathing difficulties) – the same WHO declared a global health emergency, reversing the Organization's decision just a week ago to hold off such assertion. The declaration "*is not a vote of no confidence in China*," said Tedros Adhanom Ghebreyesus, the WHO's director-general. "*On the contrary, the WHO continues to have confidence in China's capacity to control the outbreak*." The declaration comes now, he said, because of fears that the coronavirus may reach countries with weak health care systems, potentially infecting millions of people and killing thousands. Market players found comfort in Mr. Ghebresus' confidence in China to handle its epidemic and the activation of global coordination to contain the virus, with stocks staging a late-session rally and bond prices reversing earlier gains (i.e. higher yields). Following the announcement, the US State Department warned travellers to avoid China altogether. China's Foreign Ministry spokeswoman, Hua Chunying, said that the country "*is fully confident and capable of winning the battle against this epidemic*."

With fears growing over the economic impact of the spreading illness, investors' nerves have been on full display throughout the week. After all, 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 213 deaths, more than 10,000 cases and over 20 places outside mainland China!), flights are being cancelled, and it is evident that the outbreak is bound to cause economic damage, at a minimum in China where economic data will take a notable hit for many weeks to come (in an extreme scenario, a fat tail risk that covers a pandemic disease would take the global economy quickly into recession!). That possibly explains yesterday's extreme rally in 10-year US government bonds (intraday yield low of 1.54%!), which led to the inversion of the US Treasury yield curve (3-month US T-bills yielding 1.56%) and implied a serious negative outlook for the US economy. At the same time this was happening, 10-year real yields (obtained by subtracting the inflation breakeven for the same period) dropped to their lowest level since May 2013, after taking out the low they hit during the wave of pessimism that followed the Brexit referendum in the summer of 2016. And yet, despite all the surrounding negative news/noises, equity markets remain buoyant and tech stocks keep pushing up. The reason? A number of positive earnings outlooks from blue chip and tech companies (so far 73% of S&P 500 companies have beaten 4th quarter EPS estimates) keeping the upward momentum alive. However, US stocks look almost as overbought as they had been at any stage in the post-crisis decade, an excuse to take some profits off the table!

Where do we go from here?? (Seriously?☺)

One way to address such difficult/random query is to refer to a comic piece from TS Lombard that was shared earlier this week by a dear GIB colleague:

Game of Two Halves*: Every year must be divided into two. If the economy is weak in the first half of the year, you should assume a recovery in the second half. If it is strong, assume a slowdown. Whatever makes the average of the two halves - there are always two halves - close to 2.0% growth for the US.*

Economic Shocks*: Whenever something unexpected happens, like extreme weather or a government shutdown, industrial action or trade tariffs, a financial journalist will always want to know what this means for the macro economy. You need an estimate that is high enough to matter, but not so large that it would force you to change your forecast or look obviously wrong within a few weeks. A good rule is that the event will add or subtract 0.3% to/from GDP. After all, this is invariably the answer you get from sophisticated econometric models (the economists who created these models obviously caught onto this idea long before anyone else).*

Market Forecasts*: This is really hard and it's best to avoid this altogether if you can. If you can't, perhaps because you are an interest rate "strategist", your best option is to choose a forecast slightly higher of lower than the current spot price and then vary it in sync with the latest market trends. If the yields are falling, lower your 12-month forecast slightly. If you look on Bloomberg, you will see that this is exactly what the consensus does. The same approach works for oil prices.*

Forecasting the Stock Market*: Most of the time the equity market goes up so, to quote a former equity strategist colleague "you need a damn good reason" to forecast it not going up. But you should also think about the response you will get from clients, especially if you work at an investment bank. If you forecast a bear market and it goes up, everyone will think you're* *moron. If it goes down, everyone will hate you. But if you forecast a bull market and prices rise, you will become a hero (and if it goes down, nobody will remember because everyone will have got it wrong).*

And If All Else Fails, Blame "Liquidity": *Liquidity can explain *everything*, it's basically a residual. And since nobody can measure it, you can just infer its presence (or not) from whatever is happening to market prices. It's the equivalent of "confidence effects" in macroeconomics. The political right particularly like the term "liquidity" because it is a convenient way to accuse policymakers of 'distorting' markets without any actual evidence.*

N.B.: *In this week's economic summary, I should have covered the latest US FOMC meeting (unchanged rates, neutral bias), the Bank of England Monetary decision (7-2 in favour of keeping the benchmark rate unchanged at 0.75%, with 2 votes for a 25 bps rate cut), Brexit finally taking place at 11:00 pm GMT tonight, 3-1/2 years after the 52-48 referendum in the summer 2016 (though the EU's royal blue flag with yellow starts will continue flying at the entrance of the Scottish Parliament in Edinburgh ☺), basketball legend Kobe Bryant's sad death in a helicopter crash as well as Trump's impeachment trial, which will end as soon as Republicans vote to acquit the US president of high crimes and wrongdoings, though it will leave behind a country more divided than any time before. I could have also sarcastically referred to Trump's recently announced Deal of the Century, unveiled with boastful fanfare last Tuesday in the presence of a beaming Benjamin Netanyahu, that ignores countless UN resolutions, the Oslo Accords of 1993, the Arab peace initiative of 2002 and the fundamental idea that Palestinians, like Israelis are human beings with unchallengeable right to self-determination; But the matter of the fact is that none of that really matters much, as the world remains on high alert and solely focused on resolving its greatest developing challenge – the coronavirus outbreak !*

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