Perpetual Investments

THOUGHTS ON THE MARKET

21st April 2020

SUMMARY

- There were some things that we considered likely during this crisis – the weakest quarter of US growth ever, US unemployment close to 20% for the first time since 1941 and central banks becoming increasingly unconventional. Then there are things which you debate academically because you think they are highly unlikely, but you want to know the boundaries of possibilities. One of those became a reality overnight when the April futures market price for West Texas crude (the contract is due to expire today) fell below zero overnight in an unprecedented wipeout that took the oil price to USD-13.10 per barrel at the bell (a price decline of -171.7% in one day!).
- Needless to add, you may have a few questions:
    - **What does it mean?** It means that there is so much oil sloshing around US oil producers that futures market investors are now willing to pay others to take physical delivery, as investors and producers believe storage capacity will have run out by May. Accordingly, such a dramatic one-day price collapse owes much to the binding constraints of trading commodity futures into expiration.
    - **How did that happen?** There is demand for oil and its production, and when you have too much supply, you have to store it, but when all the spare storage is near its capacity (its currently at 72.4% in April having risen by 48% since February) when the contract expires, someone with the net long position has to take physical delivery of the commodity. It is a sign of expiration risk, and also its indicative for how much demand in the economy has collapsed in the COVID-19 recession, and as I wrote yesterday March economic data was bad, but the April US survey data out last week was really really grim.
    - **Is this specific for the May contract?** Yes, but you can't ringfence the contagion to one contract, the whole global oil curve was massively lower overnight - the June contract fell -15.2% to USD21.22 and the price of Brent in London dropped -7.6% to USD25.89 per barrel.
    - **Is this the worst it can get in oil?** No. The May contract expires tomorrow, so there will be more stress on the expiration window, and there is little to prevent the physical market from further acute downside risks in the near-term. Refiners are refusing to take barrels at an unprecedented pace and with storage capacity close to full, market forces will inflict a lot more pain until the price hits rock bottom because either demand lifts or more storage becomes available. This could also spook retail speculators given the negative carry incurred at each contract roll. Meanwhile, the risk of rising oil sector defaults is 100%, the question is how high does it get to.
- Needless to add that financial markets closed lower overnight with losses most acute in equity markets which fell from a 6-week high, but even then, the damage was not severe. There was no material economic data or policy announcements, but equity, credit and most commodity markets were lower, and safe havens such as US treasuries, gold and the Yen were all bid overnight. Futures markets are predicting losses at the opening in Sydney and Tokyo.

FINANCIAL MARKETS

- **EQUITIES**
    - **The MSCI World Index closed -1.2% lower yesterday. Regional losses were led by the US (-1.8%) where losses were led by utilities (-3.9%), REITs (-3.7%), energy (-3.3%) and financials (-2.0%). In Europe, prices were mostly higher with the regional gauge up +0.2% as gains in defensive sectors such as healthcare (+2.1%), consumer staples (+1.6%) and telcos (+0.7%) outweighed losses in energy (-0.5%) and REITs (-0.8%).**

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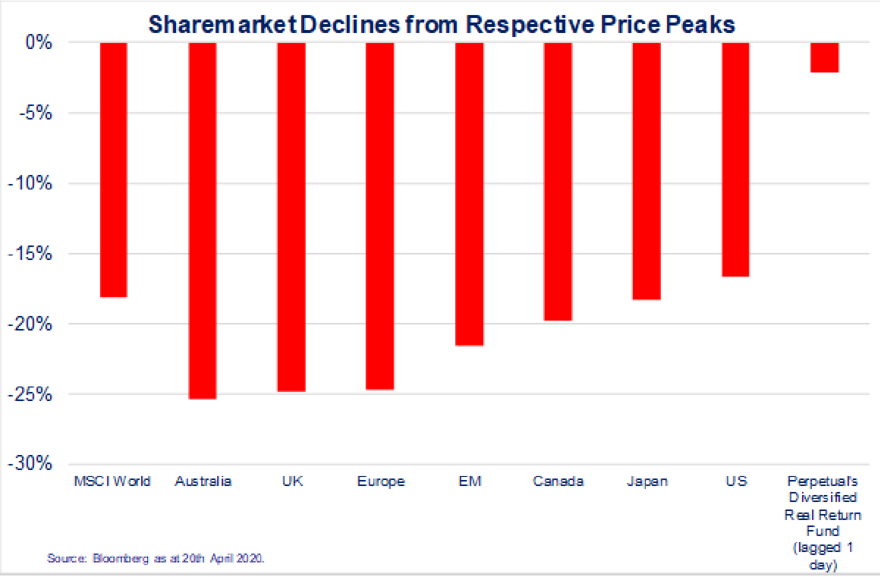
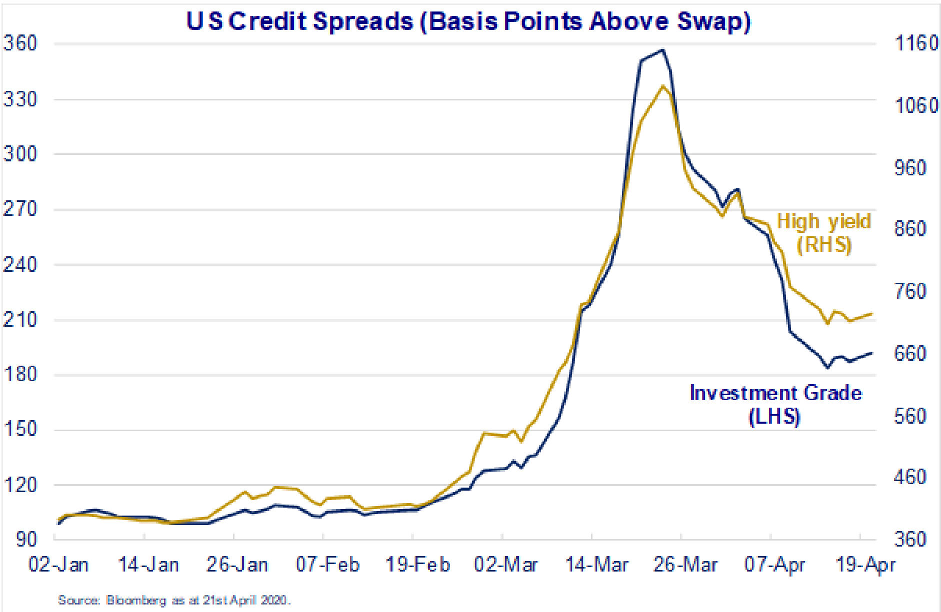
- Emerging markets closed -0.2% lower for the session and earlier in Asia, losses were prominent led by Australia (-2.5%), Japan (-1.2%) and Hong Kong (-0.2%), but China closed high (+0.4%). The decline in Australia culminated in our market now recording the largest peak to now decline (see chart) although performance is quite bunched with the UK and Europe.
- Futures markets are pointing to a -1% loss at the opening in Australia and -1.5% in Tokyo.



- **CREDIT**
  - US credit markets declined overnight but the increase in spreads was minor despite the crash in oil prices. Investment grade spreads rose +5 points to +192 bpts which took the sector's recovery rate down to 65%. Among the sectors spreads blew out the most in energy (+13 to +337 pts with a recovery rate down to 57%) and who finances them, namely subordinated financials (+6 to +239 bpts, 63%), but all sub-sectors were wider by 3-5 bpts. In the high yield space, spreads widened 13 to +726 bpts which pulled the recovery rate down to 54%. Again, energy (+34 to 1462 bpts, 56%) was the primary contributor to the increase in risk premiums with subordinated financials (+20 to +503 bpts) also materially higher, but all other sub-sectors widened 5 to 15 points.



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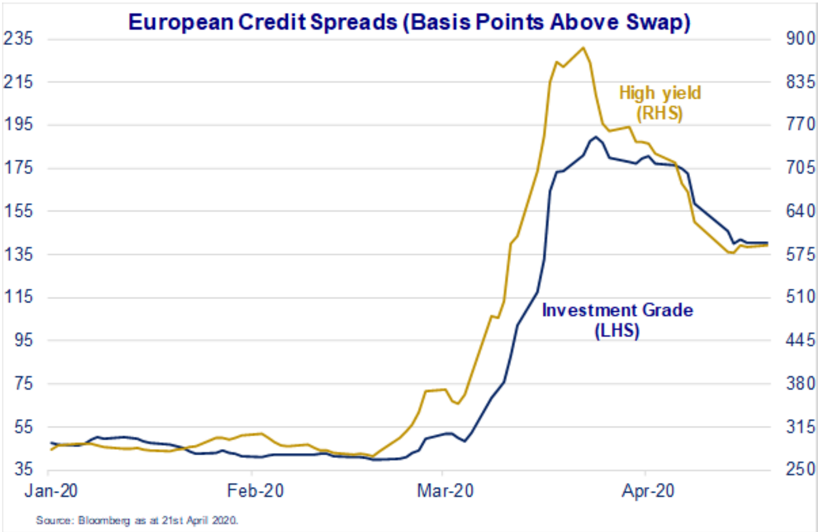
- European credit markets missed to carnage in the US energy market and closed reasonably flat. Spreads in the regional investment grade sector were unchanged at 140.5 pts (keeping the recovery rate at 33%) with no material change in any sub-sector. Meanwhile, spreads in the high yield universe rose +2 to +589 bpts (which took the recovery rate down to 48%), but it was materials (+8 to +769 bpts, 52%) which drove the widening, with modest movements elsewhere it a fairly quite day's trading.

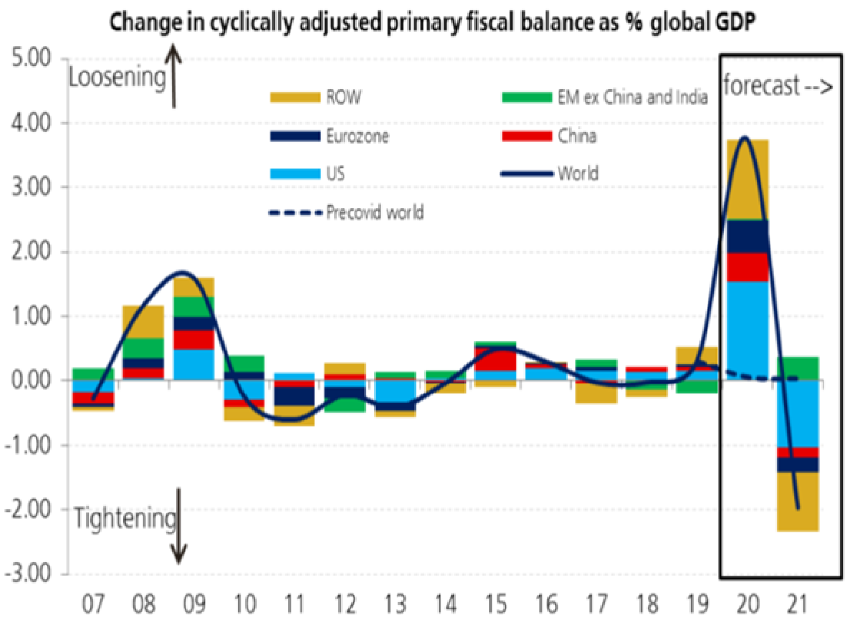


THE GLOBAL ECONOMY

- There were no key macro releases yesterday.

POLICY

- There were no material policy announcements on Monday. However, we thought we'd provide an update on the latest policy impulse. The global monetary impulse remains at around +1.5% of global GDP, but there have been more (modest) announcements in the fiscal space, which is now the go-to policy tool for reflation. Overall, the fiscal impulse is now +3.7% of global GDP in 2020 (see chart), which is well in excess of what was provided in 2008 and 2009 when monetary policy was more heavily used. Of the total fiscal support, a net increase of +2.7% of global GDP is coming from advanced economies which is more than the +2% total support in the GFC, with another +1.0% coming from the emerging markets, which is nearly double their +0.6% provided in 2008 and 09).



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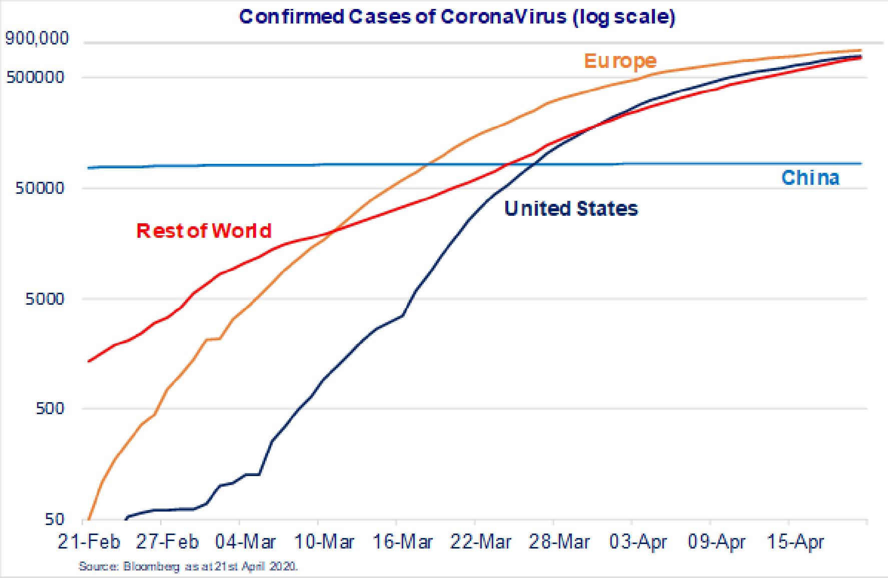
VIRUS UPDATE

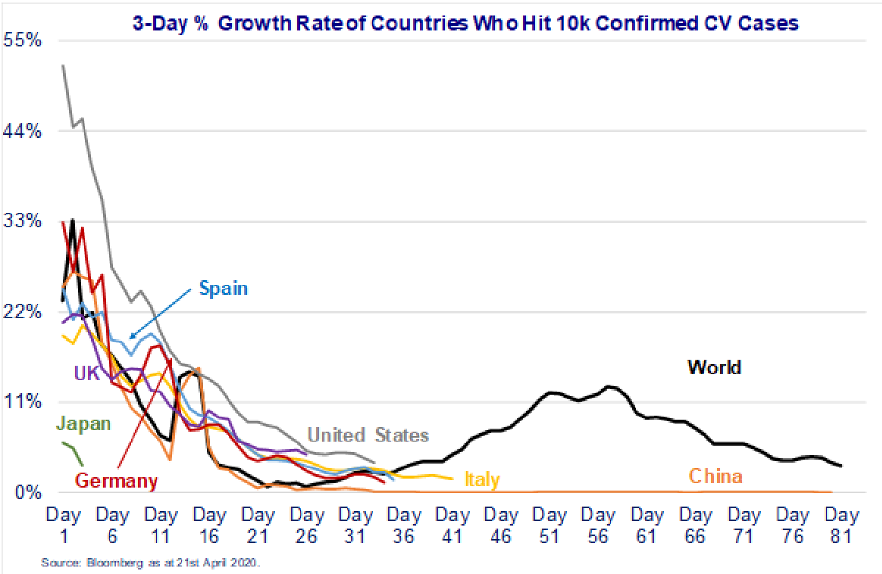
- The percentage of daily confirmed COVID-19 cases continues to decline (+3.3% since Saturday) with the number of daily increasing by +65.1k overnight (26-day low) with smaller rises in both the US (+22k) and Europe (+11k), suggesting moderation in large advanced economies, but EMs such as Turkey, Brazil and Mexico are still rising notably. The number of global cases is now at 2.47 million, deaths rose +3,891 to 169.8k but the death rate declined to 6.82% (although final numbers are not yet in).



- Europe (+11.3k to 880k) continues to lead the world in terms of total cases but its daily increase (number, not percentage) is trending lower (lowest in the past 22 days) which shows that social isolation works to reduce the spread of the virus, even though it comes at an enormous economic cost.

  Similarly, the US had its lowest daily increase of new confirmed cases in 22 days (+22.6k to 782.2k) and its 3-day compound growth rate has declined to 3.7% 33 days after they reached 10,000 cases. That said, New York cases rose +4.1k and +3.1% overnight which is now below the US average, but deaths in the city that never sleeps rose to 18.6k.

  Elsewhere, Singapore recorded a sharp increase in cases (+1,426 to 8.0k) most of which are linked to foreign workers who are forced to live in crowded dormitories, with the countries having the largest case numbers in South East Asia after overtaking Indonesia (+185 to 6,.8k) and the Philippines (+200 to 6.5k).



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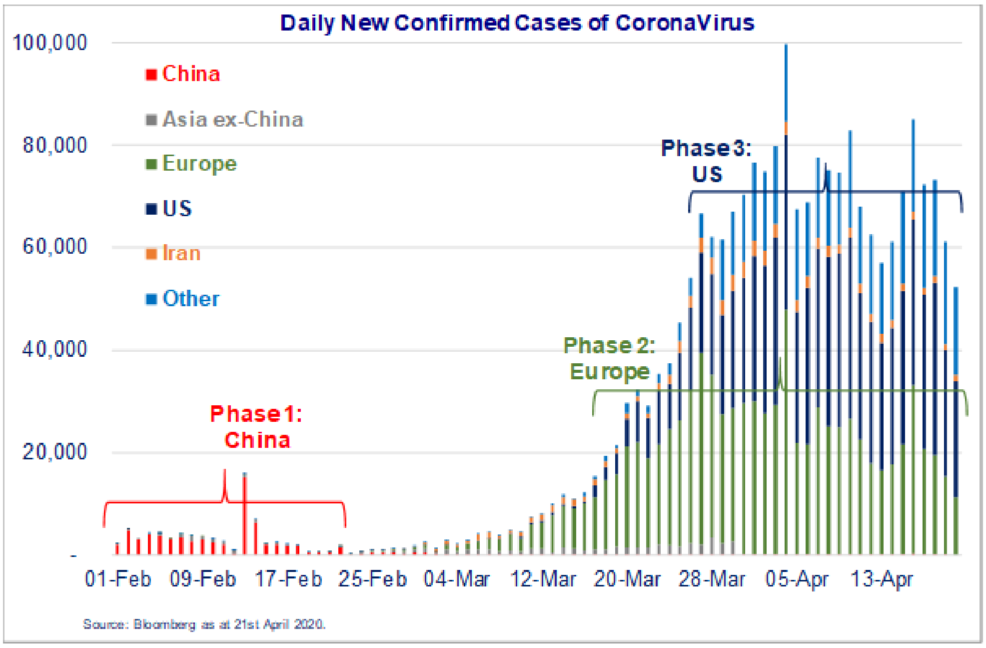
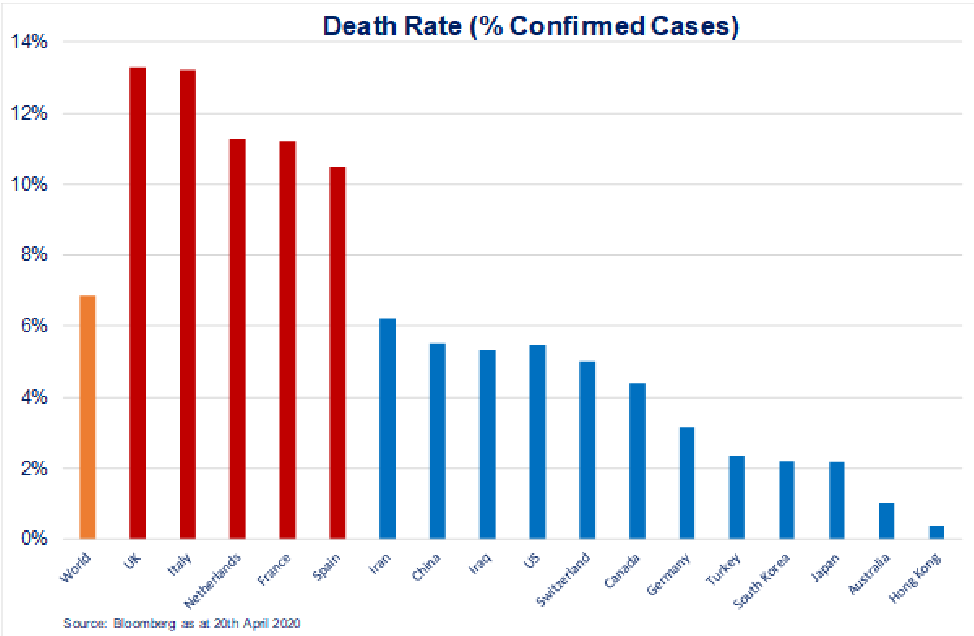
- Among countries, the most cases are in the US (+22.6k to 782.2k), Spain (+1.5k which is a 37-day low) to 200.2k), Italy (+2.2k to 181.2k), France (+2.8k to 156.5k), Germany (+0.9k (37-day low) to 146.7k), the United Kingdom (+4.7k to 125.9k), Turkey (+4.6k (fifth highest daily increase) to 91.0k), China (+0 to 83.8k) and Iran (+1.3k to 83.5k). Australia confirmed cases were unchanged yesterday at 6,547 which placed us 38th in terms of total infections.



- The global death rate has declined to +6.82% (its first decline in 37 days) with another +3.9k fatalities overnight bringing the global total to 169.8k. The death rate is highest in European countries where the health systems have collapsed led by Italy (+0.1% to 13.3%), the UK (-0.1% to 13.2%), the Netherlands (-0.1% to 11.2%), France (+0.2% to 11.4%) and Spain (-0.1% to 10.4%).



Yours sincerely,

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MORE INFORMATION

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