Perpetual Investments

# THOUGHTS ON THE MARKET

24th March 2020

## POLICY RESPONSES

- The US Congress failed to approve a USD2 trillion spending package designed to blunt the economic fallout from the coronavirus pandemic which weighed on market sentiment.
- In contrast the US Congress, the US Fed announced massive second wave of initiatives to support a shuttered American economy and funding market stresses. The Fed's made four key policy changes overnight many of which write a new chapter in the organisation's 106-year history, including:
    1. The Fed announced that it would boost QE from USD700 billion, to "whatever was needed over coming months" – so the QE program is now QE Infinity, which should boost the amount of US dollar in the system and ease the rapid appreciation of the US dollar which has had major global ramifications;
    2. Widening the scope of the QEI program to include agency commercial mortgage-backed securities and they unveiled a Primary Market Corporate Credit Facility (PMCCF) that would directly purchase eligible corporate bonds from investment grade issuers until September 30 in addition to a Secondary Market Corporate Credit Facility (SMCCF) that would buy investment grade corporate bonds in the secondary market, which could include some eligible exchange-traded funds;
    3. A repricing of its previous efforts to buy commercial paper and expanded the program to include high-quality, tax-exempt commercial paper;
    4. Expanding the Money Market Mutual Fund Liquidity Facility (MMLF) to include a wider range of securities, including municipal variable rate demand notes (VRDNs) and bank certificates of deposit;
    5. Opening a new USD100 billion Term Asset-Backed Securities Loan Facility worth USD100 billion to support the flow of credit to consumers and businesses; and
    6. Venturing somewhat into political territory the Fed noted they intend to announce a program to directly finance US companies (ahead of Congress which is still arguing over such assistance). This would be an all-out effort to ensure that the business sector remains solvent after economic activity temporarily collapses, which means they are now the lender of last resort not only to the financial system and now also the real economy. That puts them in a role that the Fed has traditionally argued belongs to fiscal policy and elected officials.

## VIEW OF THE FED OVERNIGHT

We think the Fed's QE Infinity and credit purchase announcements are highly significant because if the latter can be scaled up, it should provide a ceiling for the blow out in investment grade credit spreads which, all other things being equal, should help ease US credit conditions. However, the fund will have to be upwards of USD500 billion for this to occur. The US Fed has gone almost "all in" with the only major exclusions in their liquidity measures being purchasing junk bonds and equities, but they are opening themselves up to local and foreign currency credit risk like they have never done before, and when these inevitably arise with the growth contraction ahead, they will have to print more money. Easing credit conditions is one of the pre-requisites to stabilising markets, but equity investors still have to digest a massive de-rating of earnings in Q2

## THE GLOBAL ECONOMY

- No major data was released yesterday.



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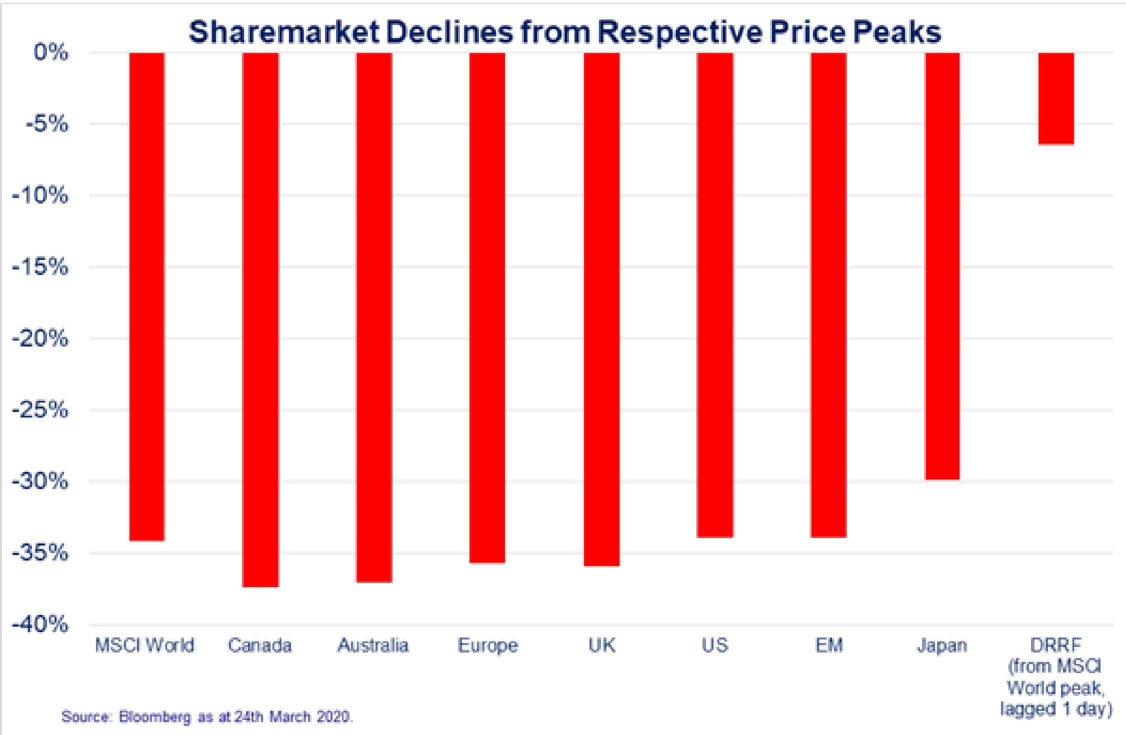
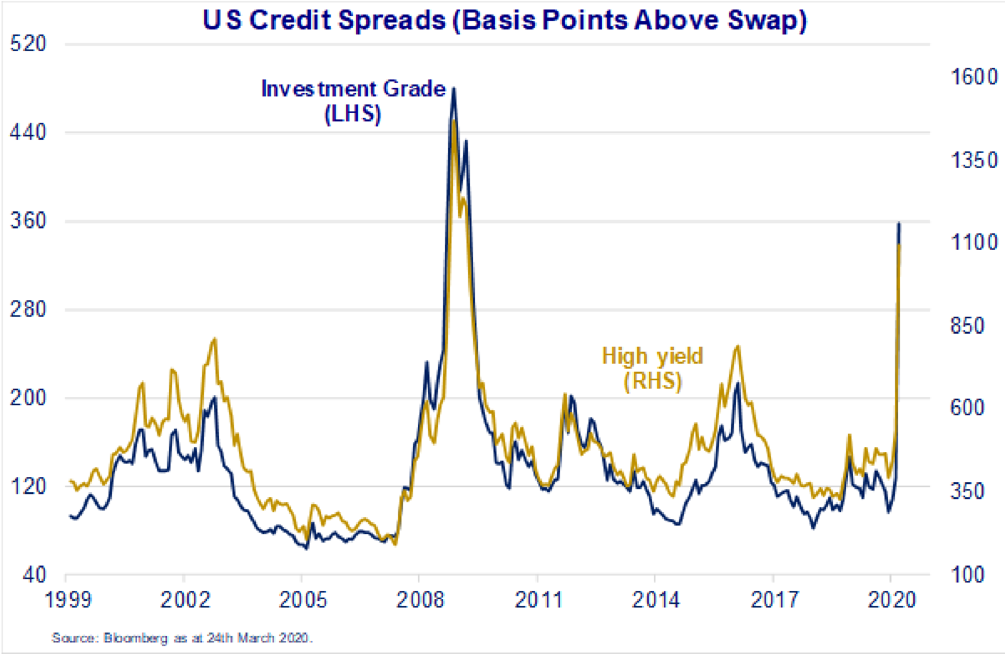
## THE FINANCIAL MARKETS

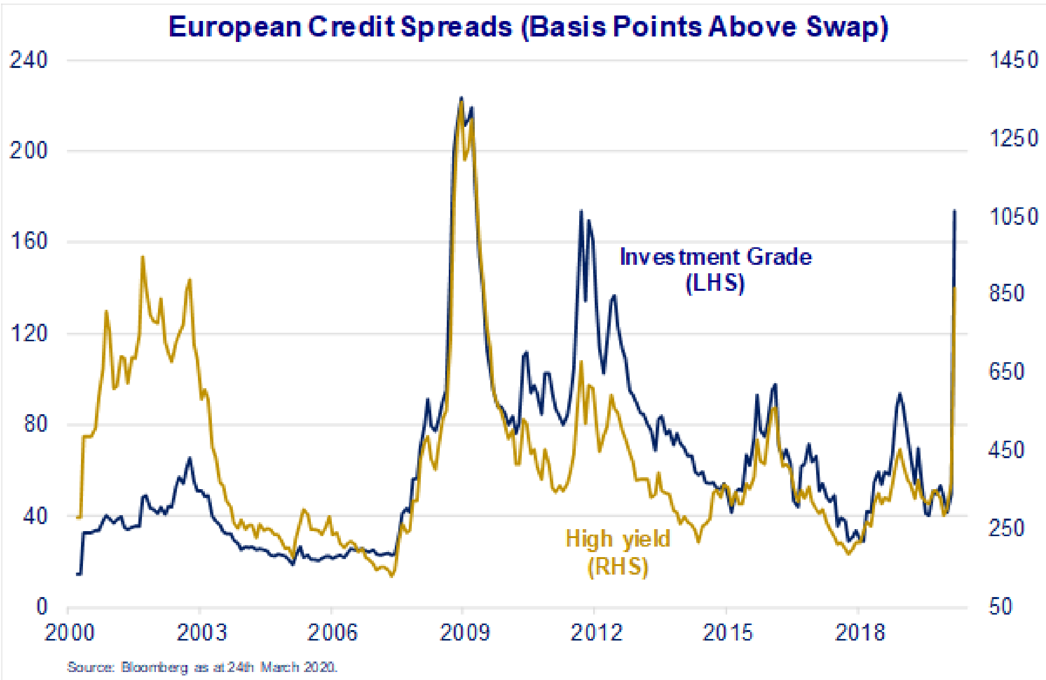
- **EQUITIES**
  - Global sharemarkets started the week on the backfoot given US political gridlock around a USD1.8 trillion spending package deal, and despite the Fed's massive second wave of initiatives to support a shuttered American economy and beleaguered financial system. In the end, given the growth hole ahead fiscal policy is more important than monetary policy in stabilising risk markets, but as the Fed gets more creative, they can become much more relevant by hoovering up nearly any distressed asset they desire. That said, the market will eventually realise this required a fiscal response.
  - The US (-2.9%) led the pace of start-of-week losses but the market closed +3% off its session lows which we believe reflects the market's initial positive view of the Fed's latest round of market supports, even though financials (-6.6% recorded one of the largest losses for the session). Losses in Europe (-2.5%) were similar as the continent's leaders imposed more onerous curbs on people movement and Italy closed most of its industrial production, with industrials (-5.1%) continuing to plummet as regional supply chains have now ceased. In Asian trade yesterday, Australia lost -5.6% (which took our peak to yesterday losses to -37.1%), Hong Kong -4.9% and China -3.4%, whereas Tokyo rose (+2.0%).




- **CREDIT**
  - Market liquidity has dried up worse than in 2008, but the Fed announcement stopped the haemorrhaging in investment grade spreads which rose "only" 7 basis points. The Fed announcement should ease credit conditions, but there's still a huge economic contraction coming. Energy IG spreads surprisingly widened despite the Fed and a +3.0% overnight rise in crude prices (+USC65 to USD23.29 per barrel) with current levels still well below the breakeven USD40 per barrel level.

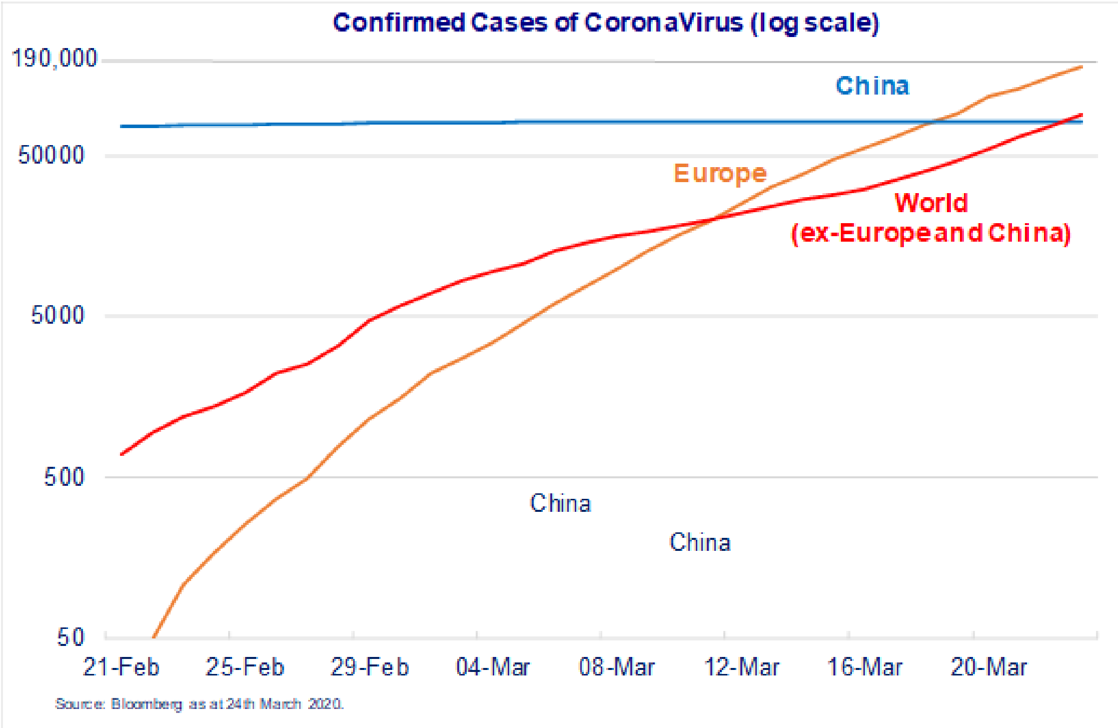



- European spreads were also wider yesterday with IG (+7.5 to 181 bpts) and HY (+28 to 867 bpts) up to yet another fresh post-GFC high. The upward thrust in the IG space was contributed by financial sub debt (+18 to 333) but rises elsewhere tended to be single-digit. In HY cyclicals led the pace of increases led by industrials (+42 to 1038), consumer discretionary (+42 to 1167) with energy (+48 to 1246 bpts) also recording sharp gains.

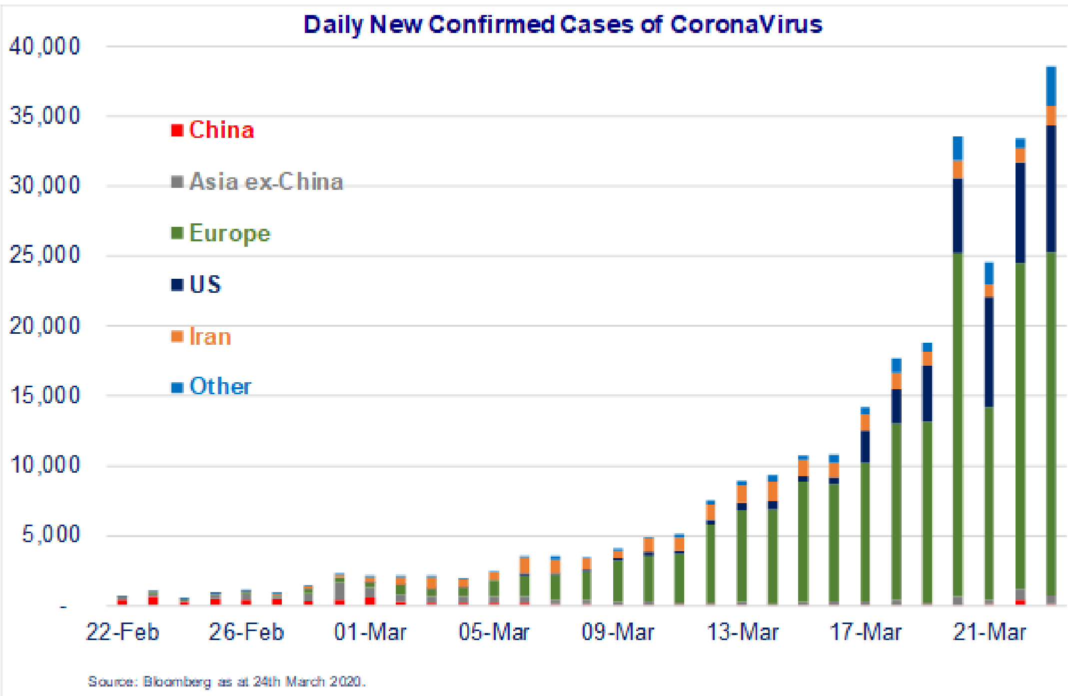


## VIRUS UPDATE

- Yesterday recorded the largest single day increase in global Coronavirus cases with a rise of +42.7k to 372.6k, deaths rose +2015 to 16.4k and the death rate rose to 4.4% (11th rise in the past 16 days despite surging case numbers);




- Europe (+24,528 to 177.2k) continues to lead the world in terms of total cases and daily new cases, and now Italy has surpassed China in total deaths (6,077 vs 3,270). Interestingly, numbers in the US are starting to rise sharply, which suggests a third phase has begun to open up.



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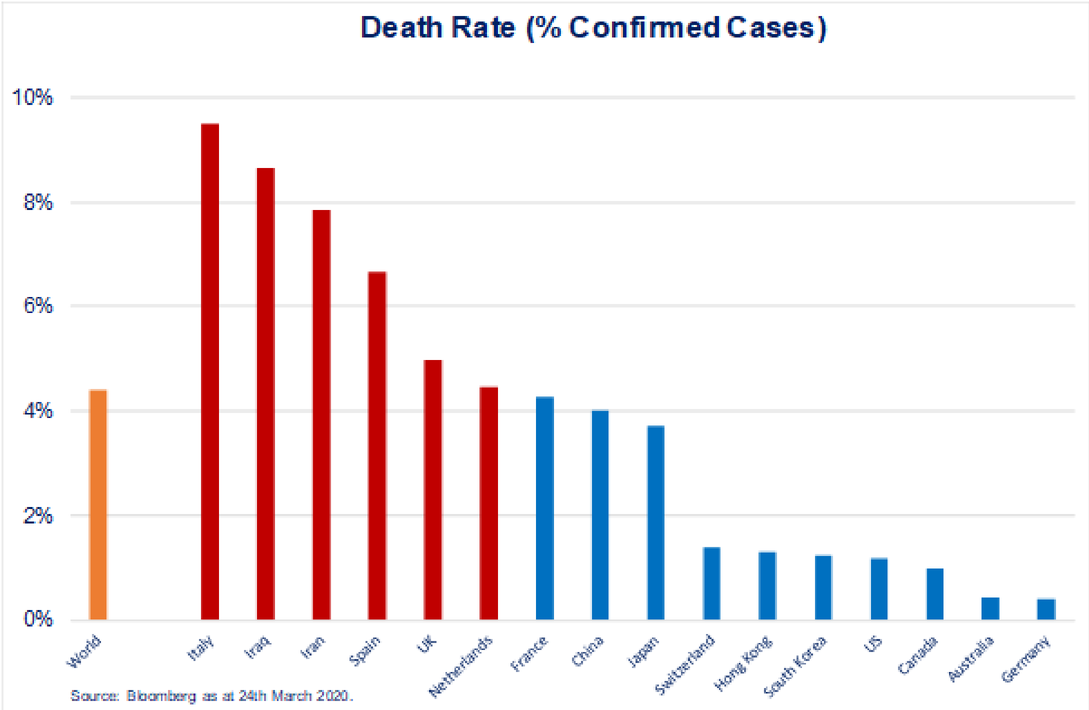
- Among countries, the most cases are in China (+99 to 81,496), Italy (+4,789 to 63,927), the US (which had its largest daily increase of +9,064 to 41,708), Spain (+4,486 to 33,089), Germany (+5082 to 29,056), Iran (1,411 to 23,049) and France (+5,619 to 20,104). Australia confirmed cases has increased (+328) to 1,642.
- The global death rate (deaths divided by confirmed cases) rose again (fractionally) to 4.4% with the worst region continuing to be Italy (+0.2% to 9.5%), followed by Iraq (-0.7% to 8.5%), Iran (+0.1% to 7.9%), Spain (+0.6% to 6.7%), the UK (+0.4% to 5.0%) and Netherlands (+0.3% to 4.5%).




Yours sincerely,

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## MORE INFORMATION

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