Weekly Digest

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Good Headlines…But No Silver Bullets

I usually give myself a week off when there is a Bank Holiday Monday (a tradition, I might add, that I inherited from the previous scribe), but in these uncertain times it feels appropriate to keep on communicating. That is especially the case when so much big news has broken since last week.

The first to report on, from last Thursday, is the Federal Reserve's latest asset purchase and loans programme, totalling another $2.3 trillion. Most strikingly, and also controversially, this allows for the on-market purchase of High Yield bond Exchange Traded Funds (ETFs). Unsurprisingly there have been complaints about moral hazard, lack of true price discovery, perpetual "zombification" of otherwise defunct companies, and stacking up even more trouble for the next recession. Even so, the market decided to celebrate the windfall first. In the two trading sessions covering Thursday and Monday, High Yield spreads came in 111 bps, and Investment Grade 37 bps. Excellent news from the point of view of our recent asset allocation decisions to add to both of those asset classes, but now bringing its own problems about what to do for an encore.

The Fed's balance sheet, never bigger than around $4.5 trillion in the post-financial crisis era, has already ballooned to more than $6 trillion, and is generally expected to head close to $10 trillion by the end of 2020. Quite how and if it will shrink again will be the big questions for the future. One might recall that measures such as zero interest rates and Quantitative Easing were intended to be temporary exceptional measures to combat the financial crisis. Now they seem to be a permanent feature. The Fed's last attempt to reduce its provision of liquidity ended pretty messily in late 2018.

Next on the agenda was Europe's €500m support package. This consists of (theoretically) "no strings" revised credit lines from the European Stability Mechanism, a boost to lending capacity from the European Investment Bank and a new €100m unemployment insurance scheme from the European Council. There is also the prospect of an as yet undefined post-lockdown recovery fund. So lots of helpful headlines.

But it is, perhaps, what was missing from the package that remains more contentious, with no sign still of Eurobonds/Coronabonds or the much hoped-for move towards some sort of EU fiscal unity. Unsurprisingly, elements of Italy's political hierarchy have expressed their feelings in no uncertain negative terms, and some commentators are suggesting that this lays the foundations for the future threat of "Italexit". The North/South divide in Europe persists, with Germany, the Netherlands, Austria and Finland most vocal in opposition to the wishes of their southern neighbours. The cracks in intra-EU relations remain (barely) papered over.

Finally, some order was restored to the Oil market, as OPEC+ and the G20 countries hammered out a deal - although you would hardly notice that from the oil price, which is just a couple of per cent higher at just over $32 for Brent crude, with WTI some $10 cheaper. The headline was a 10 million barrel per day production cut by OPEC+, with the Saudis and Russia accounting for half of that. This is planned for May and June, with a steady increase in production again thereafter. Non-OPEC cuts are more organic in nature, mainly from the price-driven decline in US shale production, and combined with increased storage and strategic reserve building will take a total of 15 million barrels off the market. However, remember that the demand shortfall is currently estimated to be in the 25-30 million barrels-per-day range, and so this is no magic bullet solution.

There is little doubt that in a world of greater certainty, these three developments would be viewed with unalloyed optimism, and it's true that credit and equity markets reflected the positives. But there is still much to be concerned about. The good news, at least, on the coronavirus front, is that the "S-Curve" of daily new cases continues to flatten, although, of course, individual countries, and even regions within countries, are all at different stages. The headline is that the latest figure for growth in the daily number of infections outside China is down to 4.3%, with last week's average being 6%. That itself is down from 10% in the previous week and 14% the week before that. However, I listened to an interview with Larry Brilliant, the renowned epidemiologist, last week, and he was at pains to stress that pandemics must be viewed as "a marathon, not a sprint". The emergence from lockdown will not be announced with a simple "all clear".

And that brings us to the three questions which suggest that the remarkable bounce we have seen in risk assets might be due a breather. How bad will the effects to control the virus be on economies, companies and individuals? How long will the disruption last? And what unexpected after-effects might there be? We have received some clues on the first question today from the UK's Office of Budget Responsibility (OBR) and the International Monetary Fund (IMF).

The OBR has published a scenario based on a three-month shutdown with current support measures in place. This suggests a 35% fall in the country's output in the April-June quarter. The calendar 2020 drop in GDP is forecast to be 12.8%, but with a 17.9% rise in 2021. Even allowing for pent-up demand, the idea that the total economy could be almost 3% bigger by the end of 2021 than it was at the end of 2019 (which effectively assumes an immediate return to trend) looks a bit far-fetched to me. There is also the debt legacy to ponder. This year's fiscal deficit of 14% of GDP will be the highest since the Second World War, with overall net debt briefly surpassing 100% of GDP during 2021.

Looking at the bigger picture, the IMF forecasts a 3% decline in Global GDP this year, one of the biggest declines I have seen estimated so far. Then a 5.8% rebound in 2021. Given the participation of emerging economies (notably China) in that recovery, I am more inclined to give it the benefit of the doubt. Regionally, it expects the Euro area to contract by 7.5% this year and to rebound by just 4.7% next. The UK follows a similar pattern of a 6.5% 2020 slump followed by growth of 4.0% in 2021. The respective US GDP numbers are -5.9% and +4.7%. China's are +1.2% and +9.2%. Understandably the IMF warns that its forecasts are subject to extreme uncertainty.

For me, though, the asset which I keep noticing that seems to be rising through good and bad news (with the exception of that mad week in March when everything was falling) is Gold. Yesterday it posted its highest close since 2012. It now trades even higher at $1,744. This suggests unease about future inflationary pressures as well as concerns over the effective monetisation of government debts via central bank asset purchases. It was notably strong through 2019 as well, even as equity markets roared ahead. It is definitely trying to tell us something.

Last week's Economic Highlights

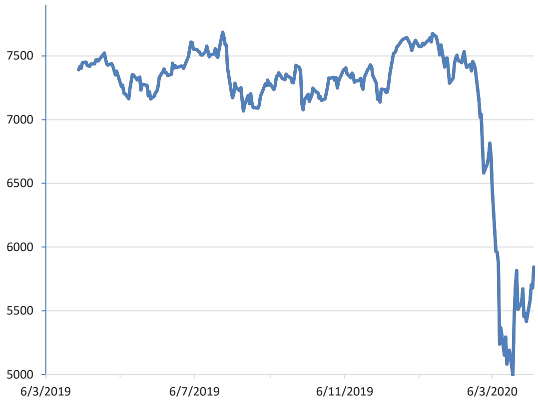
FTSE 100 Weekly Winners

Carnival plc	59.6%
GVC Holdings PLC	49.5%
easyJet plc	37.0%
Melrose Industries PLC	35.8%
John Wood Group PLC	30.5%
Taylor Wimpey plc	29.8%
ITV PLC	28.9%

FTSE 100 Weekly Losers

BP	-5.0%
RSA Insurance Group plc	-3.6%
J Sainsbury plc	-2.2%
Royal Dutch Shell Plc Class A	-2.1%
Admiral Group plc	-1.7%
Pearson	-0.6%
Royal Dutch Shell Plc Class B	-0.5%

FTSE 100 Index, Past 12 Months



Source:FactSet