

Flash

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15 June 2020

What happened?

- Equity markets had a busy week as they rallied at the start to erase 2020 losses (in the US) before collapsing nearly 6% on Thursday and rebounding 1.3% in the US and 0.3% in Europe on Friday. Indeed, fears of a second wave and a sobering outlook for the economic recovery by the Federal Reserve led markets to take a breather. This morning, following reports that cases are rising in Beijing again, futures are pointing to another sharp drop, with the US and Europe down about 2.5% -3%. For now, we do not believe this is the beginning of a March-like collapse, but higher volatility could persist, which is why we have remained prudent.
- The Federal Reserve said it would keep interest rates near 0% at least through 2022, which was beyond market expectations, but Mr. Powell's assessment of the economic impact and the shape of the recovery was more sombre than markets had been pricing in. However, Mr Powell also highlighted that the Fed wasn't looking at asset bubbles – as in, they wouldn't try to prevent or burst them – and remained more focused on unemployment, which is expected to remain high for a long time. Indeed, while last week saw the smallest number of initial jobless claims since March, still 1.5 million people files for claims, while continuing jobless claims remain at nearly 21 million. Moreover, inflation in the US was at its lowest since 2015, suggesting little pressure for the Fed to change its stance.
- US sovereign yields retreated over the week from 0.9% on 10-year Treasury yields on Monday to 0.65% this morning, as investors re-assessed the growth outlook and flows continue to run into bonds. German 10-year yields followed the same pattern, falling from -0.3% on Monday to -0.45%. Credit spreads widened as risk appetite weakened, ending the week with US IG at 159bp, EU IG at 151bp, US HY at 611bp and EU HY at 533bp.
- Oil prices got knocked as well last week, despite extended production cuts, with WTI falling back to USD34 (from 40) per barrel and Brent to USD37 (from 43) per barrel. Unsurprisingly, gold benefitted from the risk off sentiment, climbing to USD1745 per ounce before retreating to USD1720 per ounce this morning.
- We had been saying for some time that we expected some corrections, but that the downside had become more limited given a still-bearish consensus, high cash levels, and a broadening rally. We maintain this view and for now, do not believe this is the start of a new collapse. However, we had chosen to remain prudent for this very reason, and we still believe that it is too early to become too aggressive in portfolios.

What we are watching

- We look at high frequency data to see if reopening is translating into re-growing. And we keep an eye on deaths and intensive care unit cases to ensure the virus remains contained as we gradually reopen. In Europe in Asia, so far so good. We also look to see if recent encouraging news on treatments materialises.
- We continue to watch for bankruptcies and defaults, though the Fed in particular is doing everything in its power – and beyond – to limit risks of contagion.
- We will look at earnings estimates as they continue to be revised down. After a sharp drop in earnings in Q1, expectations for Q2 are even worse and could weigh on sentiment.
- We keep an eye on credit and funding markets to see if massive central bank measures, both in the US and Europe, help ease the recent stress. For now, we believe that central banks will succeed in keeping systemic risks low to prevent a credit crisis.

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