Sygnals

MARCH 2020

PANDEMIC GLOBAL LOCKDOWN

Can we quarantine the world economy?

The World Health Organisation (WHO) characterised the Covid-19 (coronavirus) outbreak as a pandemic on 11 March. Since then, numerous countries have declared a state of emergency and gone into full lockdown, including the US, UK, Italy, Hungary, the Philippines, Japan and, of course, South Africa. The devastation reached Wall Street which recorded its worst session since 1987 and fell 34% from its peak, while oil prices are down to levels last seen in 2002. The effect also touched the South African All Share Index which found a short-term bottom, 36% from its January peak.

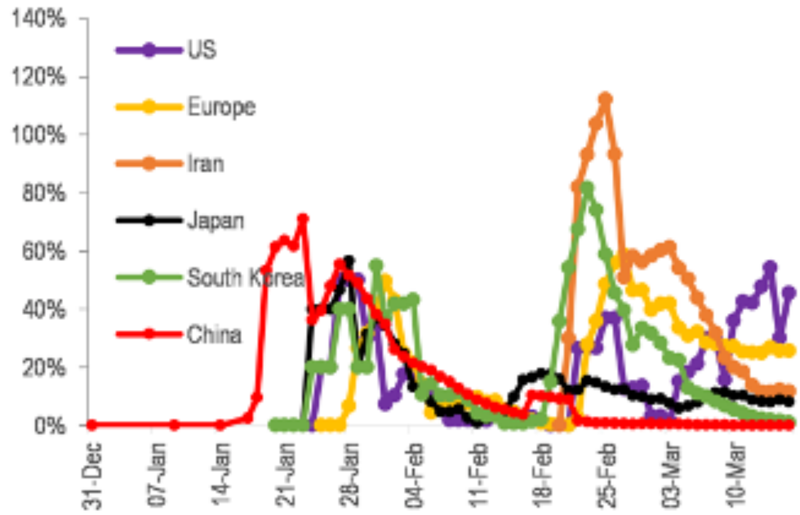
World governments have compared Covid-19 to a war, noting significant human and economic global challenges, and the impact on global GDP is somewhere between a natural disaster and a deep recession. 2020 growth will follow the pattern of a natural disaster, with the deepest GDP fall since World War II, but is expected to rebound sharply by the end of the year. However, lingering uncertainty, job losses and business closures will weigh on demand until at least the end of 2021. There have been seven global recessions over the last century of this magnitude: two driven by war (World Wars I and II), two driven by balance sheet recessions (the 1930s Great Depression and the 2008 Great Financial Crisis), two driven by oil shocks (1973 and 1981) and now the first to be driven by a global pandemic.

So where to from here? Three important issues are in play:

1. Central banks are keeping the banking system working with supportive monetary policy;
2. Governments are keeping businesses going with supportive fiscal policy and;
3. Markets are oversold and under-owned.

We will look at each of these three points in more detail, but the final catalyst will be the daily infection rate: across the globe, countries are waiting for infection rates to peak and hoping that a second round of infections will not start as countries come out of lockdown. The main focus right now is the US, which has more cases than anywhere else. US unemployment claims surged to 3.3m, five times its previous peak in 1982. After two weeks of measured optimism, Trump shifted dramatically and has extended the policy of "social distancing" until at least 30 April. Risky assets, like equities, will turn a corner when evidence emerges that the coronavirus is being brought under control.

Chart 1: Daily growth rate of reported Covid-19 infections (five-day moving average)
Source: WHO, JP Morgan



There is sufficient monetary stimulus

An abundance of central bank actions have propped up liquidity, reducing borrowing costs and, most importantly, keeping the dollar from strengthening too far (an overly strong dollar would cause monetary systems to freeze).

The Fed has cut policy rates by 150 bps and restarted "QE infinity" with $700bn of asset purchases, including credit bonds. The ECB has allowed banks to run lower capital ratios, raised their QE programme by €120bn and announced a new €830bn programme of bond purchases. The Bank of England cut rates by 65 bps, to a record low of 0.1%, and increased QE. The total asset purchase target was raised to £645bn. PBOC has lowered the required reserve ratio by 50, to 100 basis points. Many other countries have cut rates from between 25 to 100 bps and some have also implemented QE.

The BoJ has doubled its buying of ETFs and J-REITs and announced additional commercial paper and corporate debt purchases of JPY 2tn. SA's Monetary Policy Committee (MPC) unanimously cut the repo rate by 100 bps, to 5.25%.

As can be seen in the chart below, QE has reached new highs, with larger increases than after the GFC of 2008. This has capped the recent dollar rally, which neared 50-year highs, kept liquidity in financial markets and avoided excessively high borrowing costs around the world – a necessary (but insufficient) step for market recovery.

Chart 2: Central Bank balance sheets increase with more QE
Source: Standard Chartered

There is sufficient growth stimulus

Over $5tn in fiscal support has been pledged by more than 21 countries to assist consumers and help businesses deal with the impact of global lockdowns. Helicopter money, first brought into play by Hong Kong at the onset of the crisis, is being utilised by the US and other countries.

The US will inject $2tn into the economy – nearly 5% of GDP – including cash disbursements for consumers and loans for small businesses.

- China is lining up fiscal stimulus worth 2% of GDP.
- The German government is pledging at least €460bn in guarantees to cope with the economic impact of the coronavirus outbreak.
- UK Prime Minister Boris Johnson pledged a package of loans and grants for businesses to support the economy, including £330bn of government-backed loans for companies in distress.
- The IMF is ready to tap $1tn in loan capacity.
- New Zealand unveiled stimulus worth 4% of GDP.
- Poland announced a stimulus plan worth 9% of GDP.

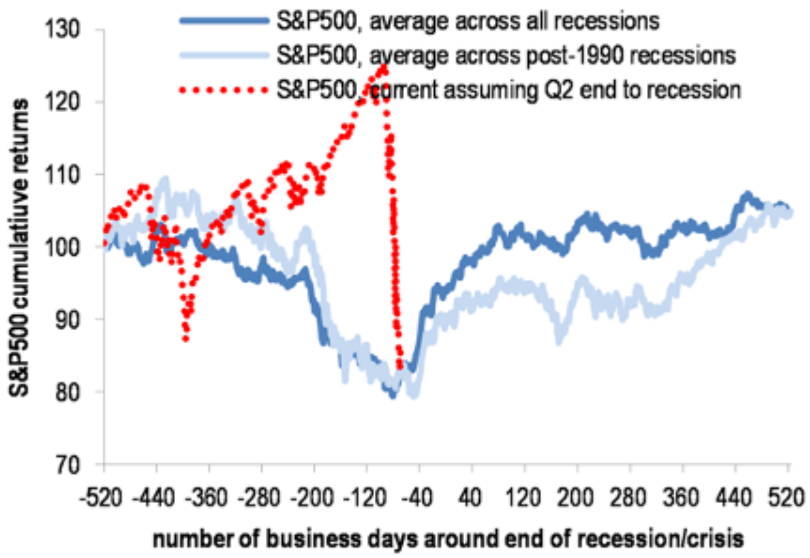
The levels of support are significant, although China is holding back relative to the 2008 crisis. China is also the first country to come out of lockdown, however, with transport levels back to almost 100%. Chinese data generated some hope as official PMIs rebounded in March from record lows and the index rose into expansionary territory, to 52.0 from 35.7. Fiscal support is in place and is the second necessary step for recovery, but is also insufficient on its own.

Technicals are looking supportive

Markets are closer to the bottom than before for a number of technical reasons:

- The end of March will see quarterly and monthly rebalancing, in which global balanced funds will buy nearly $1tn worth of equities.
- Many dynamic traders, such as risk parity funds, are at an advanced stage of deleveraging; most of these dynamic funds are already in cash.
- Signs of funding and credit stress have been alleviated by policymaker responses such as the US's QE infinity.
- Now that we have passed the March futures closeout, short gamma from the banks has reduced.
- Almost every cyclical asset trade is one to two standard deviations below their long-term averages.
- Equities have traced the average pull-back compared to the recent major recessions (see chart below).

Chart 3: S&P500 performance relative to previous recessions
Source: JP Morgan



We are getting closer

Both monetary and fiscal policy is in place, and no one can argue that the equity market is not cheap, but it could get cheaper. It will be impossible to call the bottom until there is confidence that infection rates have peaked. On the positive side: markets are fast adapting, and it is vital to stay nimble given the current conditions; Zoom's market cap is now bigger than the big four US airlines combined; the price of uranium has jumped as coal mines close, giving support to a commodity that has been in a bear market for over a decade; and oil tankers are enjoying record profits as cheap oil is in need of storage for the foreseeable future. We remain focused on harnessing the volatility to protect capital for the funds. Locally, bonds are looking closer to their bottoms than SA equities, and the recent Moody's cut is likely to be a positive catalyst that many foreign investors have been waiting for.

Key indicators

		1 month	*3 months*	*6 months*	*1 year*	*2 years*	*3 years*	*5 years*	*10 years*
J203T	FTSE/JSE All Share Index	-12,1%	-21,4%	-17,7%	-18,4%	-7,4%	-2,1%	-0,1%	7,7%
J200T	FTSE/JSE Top 40 Index	-10,4%	-19,2%	-15,5%	-16,2%	-5,7%	-0,4%	0,5%	7,8%
J210T	FTSE/JSE Resources 10 Index	-11,4%	-24,5%	-14,3%	-18,5%	7,0%	8,5%	1,4%	-0,1%
J211T	FTSE/JSE Industrials 25 Index	-1,9%	-6,3%	-6,4%	-4,4%	-3,3%	0,0%	1,7%	13,8%
J212T	FTSE/JSE Financials 15 Index	-30,7%	-40,1%	-38,5%	-39,2%	-23,4%	-9,7%	-7,3%	5,9%
J403T	FTSE/JSE SWIX Index	-14,2%	-23,3%	-19,6%	-20,9%	-10,9%	-4,6%	-1,9%	7,6%
J433T	FTSE/JSE Capped SWIX Index	-16,7%	-26,6%	-22,7%	-24,5%	-14,2%	-7,4%	-3,8%	-
J303T	FTSE/JSE CAPI Index	-13,3%	-22,9%	-19,1%	-20,1%	-9,1%	-3,5%	-0,8%	7,4%
J253T	FTSE/JSE SA Listed Property Index	-36,6%	-48,2%	-47,8%	-47,9%	-29,9%	-23,0%	-13,5%	2,8%
ALBI	JSE All Bond Composite Index	-9,7%	-8,7%	-7,1%	-3,0%	0,2%	5,3%	5,2%	7,4%
STeFI	STeFI Index	0,6%	1,7%	3,5%	7,2%	7,2%	7,3%	7,2%	6,5%
	MSCI World Index In SA Rands	-1,8%	0,8%	1,0%	11,5%	18,6%	12,1%	11,5%	16,6%
	Rand/US Dollar Exchange Rate	13,2%	27,7%	17,9%	24,4%	22,8%	10,0%	8,0%	9,4%
	Rand/Euro Exchange Rate	13,0%	25,4%	19,3%	22,2%	16,3%	11,2%	8,4%	7,2%
	Headline CPI	1,0%	1,5%	1,9%	4,6%	4,3%	4,2%	5,2%	5,1%
	PPI	0,3%	0,7%	0,9%	4,5%	4,6%	4,5%	5,4%	5,8%