Market Insights & Strategy

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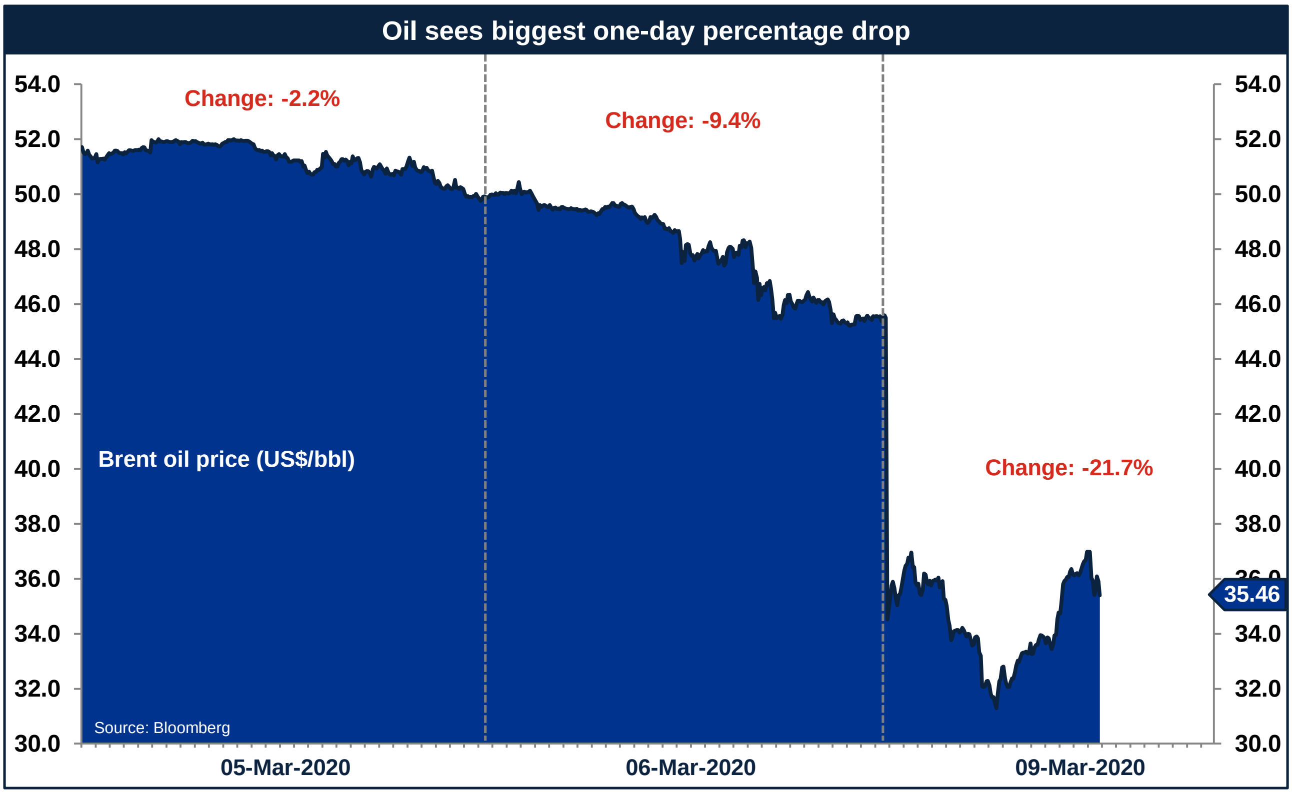
Macro Strategy View: Race you to the bottom

- They say the door marked ‘exit’ is always a lot narrower than the one marked ‘entrance’ and this has certainly proved to be the case over the past couple of sessions. The near insatiable hunt for yield and asset price appreciation seen until late February has turned 180 degrees with the corrective market moves since Friday being nothing short of stunning - even for a grey-haired, market veteran such as yours truly.
- The trigger to the global risk sell off has been the plunge in oil prices after the breakdown in production cut negotiations between KSA and Russia. With oil prices seeing their biggest one-day percentage drops since the Gulf War in 1991 equity indices have taken a huge hit and are currently around 20% off their earlier (February) highs, putting them officially in ‘bear market’ territory.



- Meanwhile, bond yields are at all-time lows. The subsequent flight to quality has seen the benchmark U.S. 10y bond yield fall to an historic low of 0.3228% earlier today, albeit currently back around the 0.415% mark at the time of writing. This is still a far cry from the 3.23% level that the bond was trading at back in November 2018. And across in the U.K. the race to be bottom has taken the 2y Gilt yield into negative territory for the first time ever; 'Germanification' of the U.K.

Race you to the bottom

- These are irrational market moves though, and completely unjustified, we would argue, either in terms of the global macro outlook or the impact of the still-spreading coronavirus, COVID-19. But the key threat to market sentiment now is that price action is becoming a self-feeding, vicious spiral.
- While we do not subscribe to the U.S. recession scenario from a macro perspective, we are fearful that sustained negative risk asset price action could now actually force a technical recession in the U.S. and Europe over the coming months and certainly before 1H2020 is finished. As such, this must surely now raise the chances of seeing increased coordinated fiscal spending and helicopter money from central banks over the coming months.
- This will present compelling buying opportunities in time, we believe, although adopting such a strategy in the coming days may be akin to catching a falling knife. One should never assume the ability to call the bottom and it would be better to miss the initial few basis points of recovery than buy into the beginning of another crash lower. But the rebound will surely materialise in time.
- Coronavirus will prove transitory eventually and we would expect sentiment toward the oil price stabilise in time as the major producers enact a careful cost/benefit analysis of chasing market share versus the implications for absolute petrochemical revenues. But for now expect the market to remain in defensive mode. Until we see evidence of any aforementioned coordinated central bank fiscal spending or helicopter money, we would advocate selling into short-term air pockets of perceived strength.

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