LAKEVIEW CAPITAL PARTNERS – March 23, 2020

LAST WEEK IN REVIEW

Stocks suffered another week of steep losses, as concerns deepened over the novel Coronavirus and its economic impact. The S&P 500 Index fell back to its lowest levels since early 2017, while the Dow Jones Industrial Average touched lows not seen since late 2016.

The downdraft was the most intense on Monday, with the Dow suffering its largest percentage loss since 1987 and the Nasdaq Composite Index experiencing its sharpest daily decline on record, according to *The Wall Street Journal*. The sell-off came despite the Federal Reserve's announcement on Sunday that it would slash the federal funds' target rate to the 0.00%–0.25% range and restart aggressive purchases of Treasuries and agency mortgage-backed securities. On Monday, the Cboe Volatility Index (VIX) hit its highest level on record, surpassing its peak during the financial crisis of 2008. Sharp declines on Monday, and Wednesday again triggered "circuit breakers" designed to keep trading orderly. The New York Stock Exchange announced on Wednesday that it would temporarily move to fully automated trading beginning Monday, March 23.

Energy stocks were weak as oil prices were extraordinarily volatile but finished the week much lower. Hospitality and airline stocks were also especially volatile. Consumer discretionary shares showed some resilience, helped by a substantial rise in Amazon.com, which announced that it is preparing to hire 100,000 workers to meet booming demand.

The blizzard of factors driving the market's losses only grew in number during the week, but prominent among them appeared to be:

- President Donald Trump stated Monday that the Coronavirus might not be contained until late summer, and governors and mayors announced closures of schools, restaurants, and other public facilities.
- Economists at major banks slashed their global growth forecasts, while many predicted the U.S. would fall into a recession—if it is not already in one.
- Signs grew of increasing strains in corporate credit markets. On Wednesday, Boeing revealed that it had fully drawn down a nearly $14 billion credit line, although it still had access to others.
- The "big three" traditional U.S. automakers agreed to union requests to temporarily shutter factories.
- Oil prices reached the lowest level in almost two decades on Wednesday.
- A prominent hedge fund manager told CNBC that he was expecting an economic depression, although he later qualified his remarks by saying that the outcome could be avoided with proper actions.

Factors supporting periodic upswings included:

- The Federal Reserve announced Tuesday that it was establishing lending facilities to support the market for commercial paper, or very short-term loans used by corporations to fund operations. The Fed also announced new coordination measures with other central banks to support the international supply of U.S. dollars through the borrowing of dollars in non-U.S. currencies.
- As reported over the weekend by Bloomberg Hedge funds' excessive leverage has contributed to volatile swings in the Treasury market. Traders have blamed hedge funds that are arbitraging treasuries for continued issues in repo markets, especially after lending rates spiked in September to 10% from about 2%. Last week the Fed effectively bailed out those hedge funds by adding trillions of dollars of liquidity, helping them to unwind positions with little loss on the funds.
- Congress and the White House agreed on the outlines of a roughly $1 trillion stimulus plan designed to send money directly to U.S. citizens while supporting small businesses and strategic industries.
- China and South Korea announced significant progress in containing their coronavirus outbreaks.
- Oil prices rebounded and posted their largest daily percentage jump ever on Thursday after a report that the U.S. may intervene in the Saudi Arabia-Russia oil pricing clash. Additionally, the Energy Department submitted a formal request to buy up to 30 million barrels for the Strategic Petroleum Reserve. Oil prices slipped again on Friday, however.
- Hopes grew that an antiviral drug developed by Gilead Sciences might prove useful in fighting the Coronavirus. At the same time, interest increased in a popular anti-malarial treatment that could also be useful.

U.S. - MARKETS & ECONOMY

Last week it was reported that sales of previously owned houses in the U.S. surged 6.5 percent from the previous month to a seasonally adjusted annual rate of 5.77 million units in February of 2020, above market expectations of 5.5 million. It is the highest level since February 2007. Single-family home sales sat at a seasonally-adjusted annual rate of 5.17 million, up from 4.82 million in January. Existing condominium and co-op sales were recorded at a seasonally adjusted annual rate of 600,000 units in February, about even with January's sales. There were 1.47 million houses available; at February's sales pace, it would take 3.1 months to clear the current inventory, the same as in January. The median house price increased 8 percent year-on-year to USD 270,100.

US STOCKS

Index	Friday's Close	Week's Change	% Change YTD
DJIA	19,173.98	-4011.64	-32.81%
S&P 500	2304.92	-406.10	-28.66%
Nasdaq Composite	6879.52	-994.71	-23.33%
S&P MidCap 400	1257.86	-288.79	-39.03%
Russell 2000	1014.05	-194.91	-39.22%

SOURCE: BLOOMBERG. THIS CHART IS FOR ILLUSTRATIVE PURPOSES ONLY AND DOES NOT REPRESENT THE PERFORMANCE OF ANY SPECIFIC SECURITY. ***PAST PERFORMANCE CANNOT GUARANTEE FUTURE RESULTS.***

US YIELD

Markets welcome U.S. Treasuries to the world of negative interest rates.

Short- and intermediate-term Treasury yields decreased after the Fed's interest rate cut, while longer-term yields increased, moving the Treasury yield curve to its steepest point in the last 12 months. The yield on the 10-year Treasury note continued to fluctuate in a broad range, moving from under 0.70% on Monday to just above 1.25% on Thursday before trading around 0.95% on Friday.

Treasury bills with maturities of six months and less traded at negative yields on Wednesday, as billions of dollars pushed into government money market funds. The intense flows into these funds came at the expense of prime money market funds, which can invest in corporate obligations. To address concerns about a run on prime products, the Fed implemented a liquidity facility allowing prime money market funds to unload specific securities.

The selling pressure on municipal bonds intensified as they underperformed Treasuries. On Friday, the Fed added high-quality municipal debt with maturities of one year or less to the list of securities included in the money market liquidity facility.

Despite the sell-off in assets with credit risk, Thursday's relative stability in equities markets, higher oil prices, and increased demand from investors in Asia prompted some high-quality investment-grade corporate bond issuers to bring new deals to market. High yield bonds traded sharply lower amid industry-wide outflows from below-investment-grade funds. Traders I spoke with reported that communication and liquidity continued to present challenges as more market participants worked from home.

YIELD CHECK - US TREASURY MARKETS

3 Mth: - 27 bps to -0.03%
2-yr: - 18 bps to 0.31%
5-yr: - 26 bps to 0.72%
10-yr: - 11 bps to 0.85%
30-yr: - 11 bps to 1.42%

SOURCE: BLOOMBERG. YIELDS ARE FOR ILLUSTRATIVE PURPOSES ONLY AND DOES NOT REPRESENT THE PERFORMANCE OF ANY SPECIFIC SECURITY. ***PAST PERFORMANCE CANNOT GUARANTEE FUTURE RESULTS.***

INTERESTING NEWS OVERSEAS

European equities posted sizable losses, as countries imposed lockdowns and economies faltered, raising the prospect of a prolonged recession. However, a flood of fiscal stimulus and further interest rate cuts helped equities claw back some losses at the end of the week. The pan-European STOXX Europe 600 Index fell 1.85%. Germany's Xetra DAX Index slipped 3.56%, France's CAC-40 Index declined 2.51%, and Italy's FTSE MIB Index dropped 0.4%. The U.K.'s FTSE 100 Index slid 2.78%.

The sell-off continued in the early part of the week despite government pledges of further financial support and central bank injections of economic stimulus, as countries moved into lockdown and closed borders or tightened border controls to contain the coronavirus outbreak. In the European Union (E.U.), governments considered a sizable fiscal package to support economies. Finance ministers agreed to an increase in spending of 1% of gross domestic product (GDP) and discussed how the European Stability Mechanism might be used to tackle the crisis. German Chancellor Angela Merkel said the federal government would not rule out joint E.U. debt issuance to help contain the impact of the Coronavirus.

In Spain, Prime Minister Pedro Sanchez pledged financial support of €200 billion, while the government announced measures to take over private health care providers. Sweden's central bank increased quantitative easing after an emergency meeting, and Denmark introduced liquidity measures for jobs and businesses.

The Bank of England (BoE) said it would create a corporate financing facility to provide funding for businesses. Like in the U.S., Prime Minister Boris Johnson began gradually introducing more stringent social measures to contain the outbreak. Meanwhile, after the head of the Austrian central bank said the monetary policy had reached its limits, the European Central Bank (ECB) issued a statement reiterating that it stands ready to adjust all its instruments to cope with the crisis.

Many European companies have begun revising or suspending earnings guidance on expectations of a deepening slowdown. Scores of companies have announced withholding dividend payments in the U.K. Travel stocks were among the hardest hit as the E.U. said it would curb most foreign travel for 30 days. Airlines announced measures, including grounding fleets, reducing flights, and laying off employees.

Japanese stocks produced mixed returns in the holiday-shortened trading week. Japanese markets were closed on Friday to celebrate the Vernal Equinox Day holiday. The Nikkei 225 Stock Average declined 878 points (5.0%) on Thursday and closed at 16,552.83, down 30.0% for the year-to-date period. The large-cap TOPIX Index and the TOPIX Small Index posted gains for the week but are down 25.5% and 29.5%, respectively, in 2020. The yen weakened and stood at ¥109.81 per U.S. dollar on Friday.

The BoJ policy meeting scheduled for March 18–19 was moved up to Monday due to the coronavirus outbreak. The meeting yielded results that were mostly in line with expectations. The key central bank initiatives included a temporary increase in commercial paper and corporate bond-buying through September and a doubling of exchange-traded funds and Japanese real estate investment trust purchases. As expected, the central bank did not lower interest rates. Some analysts believe Governor Kuroda is saving lower yields as a measure of last resort—for example, if the yen appreciates sharply. Most analysts believe that the BoJ is running out of policy options and that the latest efforts will have minimal impact on resuscitating economic growth. The BoJ again confirmed that it would not hesitate to take additional easing measures, if necessary.

China's equity markets fell over the week. The Shanghai Composite (SHCOMP) index dropped by 4.9%, while the CSI 300 index of large-cap stocks lost 6.2%. Both indices recovered some ground on Friday, with the SHCOMP up 1.6% and the CSI 300 gaining 1.8%.

China encouragingly reported two consecutive days with no new domestic cases of Coronavirus (take that with a pound of salt). While imported cases continue to be published daily as Chinese return from overseas, China's border controls seem to be effective at screening and detecting these cases, as there have so far been no reports of community clusters caused by imported cases.

China's fixed-asset investment shrank 24.5% in January and February (year on year), much steeper than the consensus estimate of a 2% fall. Industrial production declined 13.5% (versus a consensus estimate of -3%), and retail sales fell 20.5% (versus a consensus estimate of -4%). In response to the disappointing data, brokers and economists cut their GDP growth forecasts for the first quarter and 2020 overall. Some investment banks believe the annual fall in the first-quarter GDP may be as much as 9%.

While the extent of the declines in crucial monthly economic data was jarring, investors will be watching whether China's economy remains on a recovery path and if Beijing can jumpstart the process via appropriate policy innovations. On the first point, the high-frequency data are continuing to improve. Daily coal consumption is around 80% of the average level, while approximately 65% of migrant workers have returned to their place of work. Mass transit journeys remain about 70% below average, though local authorities are rapidly loosening strict quarantine arrangements across China.

On the second point, it appears that China intends to rely more on additional construction and infrastructure spending to reboot the economy than on direct income transfers (like the U.S.) to all households in a particular locality (where a proportion of the transfer would leak into savings).

THE WEEK AHEAD

The novel coronavirus will continue to dominate the headlines, with investors monitoring the spread of Covid-19 and hoping for more stimulus measures from central banks and governments worldwide. On the economic data front, the U.S. jobless claims are seen jumping to a record high. At the same time, flash PMI surveys for the U.S., U.K., Eurozone, Japan, and Australia will provide an insight into the early impact of the pandemic on the global economy. Other key data to follow include the U.S. final Q4 GDP, personal income and outlays, and durable goods orders; the U.K. interest rate decision and inflation rate; and the Eurozone consumer morale.

Be safe, hang in there, and call us if you have any questions.

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