PERSPECTIVES

CORONAVIRUS FEAR SHOCKS GLOBAL MARKETS

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Coronavirus has sent shockwaves throughout global financial markets. Since mid-February major global equity indices are down by 10-20%, investment grade US dollar credit spreads have widened by 30-50 basis points, and US Treasury yields have plummeted to all-time lows. The driving force behind this market turmoil is fear of the unknown. Nobody can predict how the virus will spread. Given how little testing has occurred to this point, frankly nobody even knows how many people have the virus today.

The economic impact from the virus is also highly uncertain. China's draconian efforts to contain the spread of the virus effectively shut down huge swaths of their economy, which in normal times is the single largest contributor to global growth. The expected growth impact has elicited a response from central bankers around the world, including a 50 basis point intermeeting rate cut by the Fed on

Tuesday, just two weeks before their regularly scheduled FOMC meeting. While some policy response seems justified given the sharp tightening of financial conditions, cutting rates in such an emergency fashion (the Fed's first intermeeting rate move since October 2008) seems to have exacerbated volatility and negative sentiment.

The Fed's action also highlighted longstanding concerns about the amount of policy space available to central bankers. The Fed has already spent half of their interest rate ammunition, cutting their target range for the federal funds rate from 2.25-2.50% last summer to 1.00-1.25% currently. Interest rate markets are pricing them to cut to zero by November. Rising expectations that the Fed will resort to quantitative easing soon thereafter have contributed to declines in longer-term Treasury yields this week. The ECB's policy rate is -50 basis points and they are fast approaching self-imposed limits on the amount of sovereign and corporate bonds they can purchase in their quantitative easing programs. The Bank of Japan has effectively been out of ammunition since introducing their yield curve control policy in 2016. The most effective coronavirus response will come from public health officials and fiscal authorities, but the lack of monetary policy space causes legitimate concern among financial market participants who have come to count on central bankers to restore confidence during times of crisis.

Though we acknowledge the uncertainty associated with coronavirus, we take some comfort from the remarkable strength of the US economy heading into this episode. Growth remained above trend through 2019 despite the trade war and associated industrial slowdown. The labor market is as strong as it's been in 50 years, as evidenced just this morning when the payrolls report counted 273,000 jobs added in February and an additional 85,000 in revisions to prior months. Consumers have reduced leverage since 2008 and are in the best financial shape in a generation. Corporations have increased leverage, but also extended the maturity and reduced the interest cost of their borrowing.

We have spoken with many clients this week. There are no easy answers at a time of such elevated uncertainty but we stand ready to help you think through any decisions you may be considering. Though liquidity has certainly deteriorated amidst the heightened volatility and many bond dealers are implementing workforce contingency plans, markets are functioning and we continue to execute transactions on behalf of our clients without interruption. Please do not hesitate to reach out if we can be of any assistance.

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