COLOMBO

Lugano | Zürich | Genève

mar
06
2020

Monthly Market Update

Monthly focus on Financial Markets

Contents

- Market analysis
- Executive Summary
- Trade Ideas
- Central Banks
- Macro
- Commodities
- Forex

Alberto Tocchio - CIO
alberto.tocchio@colombo.swiss

"The market believes that global central bank intervention and liquidity-driven policy actions will be able to decouple asset prices from fundamentals and Macro deterioration again. We instead believe that coronavirus is the new tariff for markets, hoping it could be contained soon."

Market Analysis

We started being very cautious last month, explaining how different 2020 would have been from the previous year and mentioning that we were seeing several red flagging lights. The starting point of this year was already fragile with declining profitability, high levels of leverage, record-low volatility and expensive valuations.

The coronavirus has proved to be the best possible excuse for the market retracement, as there was little room for a negative surprise. As it always happens, a few-day correction could easily erase the little gains achieved in a longer period.

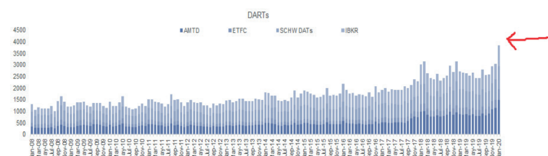
We were right being concerned about how hard the virus would have damaged the world economy and we were surprised about the market complacency on this issue.

On our daily updates, (see the link to Twitter/ Linkedin/Website below), we called extreme caution on the 19th of February as were seeing an extreme positioning for most investors, a level of speculation that we have seen before in 2000 only.

For the week ending on the 14th of February, traders bought to open nearly 24 million call options, which is the most in history. No other 7-week stretch has come even close to this level of speculative action. Gross leverage from Hedge Funds was at the 100th percentile since 2010. Even retailers started participating on the market rally since the beginning of the year, a classical pattern of capitulation.

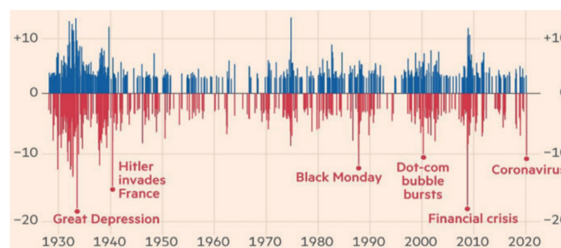
At the same time, cash levels were at the lowest point since 2013 and volatility was at record low levels across different asset classes.

US RETAIL VOLUME



What a difference just a week makes! 10% weekly decline is rare; last week's 11% drop in MSCI World is among the worst crash over the last 50 years, beaten by the post-Lehman (-20%) and 1987 crash (-14%) only. It took only 6 days for the S&P to drop 10% from a record high and the Dow lost 1,000 points for 2 day in a row. The VIX (volatility on the S&P500) had the largest weekly spike ever. Check the most famous historical corrections in the chart below please.

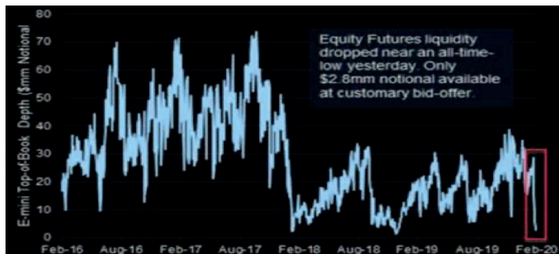
WEEK-ON-WEEK CHANGE IN S&P500



Listed option volume has reached a new record on the downturn, but instead of buying Calls, like few days ago, there was a run to buying Puts and selling ETFs.

As we have been warning over our last newsletters, poor market liquidity hasn't helped, representing an issue even for the months to come. If we look for example at the S&P500 futures, the top of the book has quickly deteriorated to new lows such that if you were forced to sell a decent chunk you would have substantially moved the market.

E-MINI EQUITY FUTURES TOP OF BOOK DEPTH (VERY LOW LIQUIDITY)



The double-digit correction has quickly erased all gains accrued since September/ October last year; the false breakout we have seen on most Indexes has proved to be very short-lived.

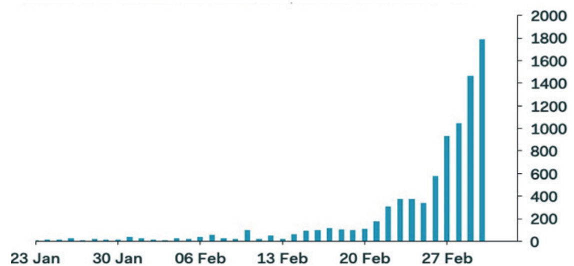
DOW JONES INDUSTRIAL AVERAGE TECHNICAL ANALYSIS

Commodities were completely smashed, with Crude WTI losing up to 30% since January highs.

As far as Fixed Income is concerned, we mentioned over the last newsletter how we had the best start ever in January with almost $72 billion of inflows, close to the 60-week record of the great financial crisis, asking ourselves if investors were worried about a potential downturn. Now we know the answer! Like in December 2018, the Bond market came to a virtual standstill, with Wall Street banks having 4 consecutive days without any High-grade bond offerings.

While China is attempting to restart its economy after an unprecedented lockdown, the virus continues to spread globally, and data on the sizeable economic fallout starts to trickle in. We know that 90% of the cases are currently in China, South Korea, Italy and Iran, the number of cases in other countries is rising at an accelerating pace.

NUMBER OF NEW CORONAVIRUS CASES, EX MAIN-LAND CHINA



Importantly, the market now believes that there will be a global coordinated central bank intervention and liquidity-driven policy actions will be able to decouple asset prices from fundamentals and Macro deterioration again.

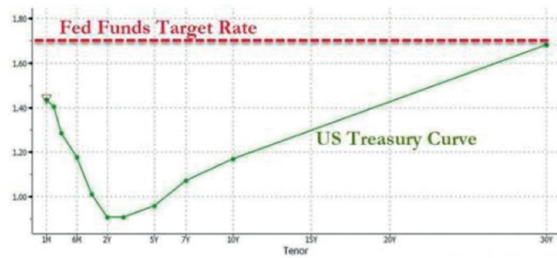
On Monday, the BOJ (Japan) bought more than 100 billion Yen of ETFs, 40% higher than their previous limit, giving a strong message to the market. On Tuesday the Fed decided unanimously to deliver an emergency rate cut of 50bps with Trump suggesting “more easing and more cutting”.

With the entire US curve yield below the Fed fund rate, the market is implying up to 100bps cut in 2020 and with recession risk on the rise in Italy and France, credit risk is

Private and confidential - For professional investors only - Not for distribution

showing up again as an early test for Ms. Lagarde who could potentially cut next week.

THE ENTIRE US CURVE YIELDS BELOW THE FED FUND RATE



Over this newsletter, we will briefly have a look at the major areas where we could spot the first important signs to better understand the market direction for the next weeks.

Executive Summary

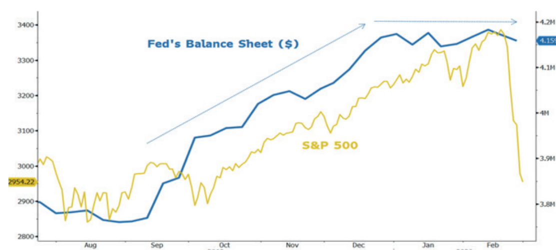
We started this year with expensive valuations, falling profit growth but still generous central banks and high investor expectations on the back of a strong 2019 for most asset classes. Few would have had Coronavirus on their list of concerns for 2020, but expensive markets are more susceptible to shocks, wherever they may come from.

Over the last newsletter, we warned investors to start being more cautious as the market was being "priced for perfection" and valuations were really stretched (in just 11 months, S&P forward P/E going from 13.5x to 19x).

Positioning is still crowded, leverage is high and factor correlations are getting more unstable. We strongly believe that higher volatility is here to stay.

It is not only a coincidence that as soon as the Fed balance sheet started to expand at a reduced rate (Repos reduced to $126 billion now from $256 billion at the beginning of the year) the market started to falling off.

FED'S BALANCE SHEET (BLUE) VS S&P500 (YELLOW)



If we want to witness a sustainable rally on risky assets, we will need growth to drive returns; while Chinese activity is likely to experience a significant hit in the near term, it seems that credit backdrop, housing market and external liquidity are better than previous viral outbreaks. If the situation will soon be contained, economic growth should recover fairly quickly.

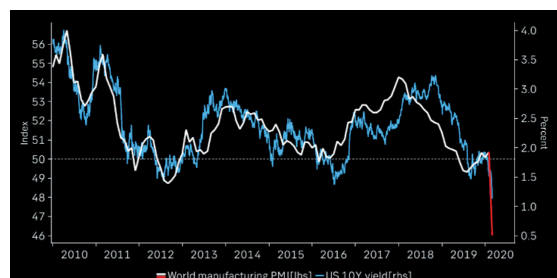
It is also true that stocks could remain under pressure for longer due to a more pronounced and prolonged activity hit as well as continued acceleration in infections.

The real turning point will be when it becomes clear that the contagion rates are peaking globally, potentially sometime in April-May, the market could stage a more sustained rebound. This could also coincide with some peaking in the uncertainty over the US Presidential elections.

Coronavirus is the new tariff for the markets. Even on the latest Fed's Beige Book, there were 48 mentions of the virus compared to none in the prior report out in mid-January.

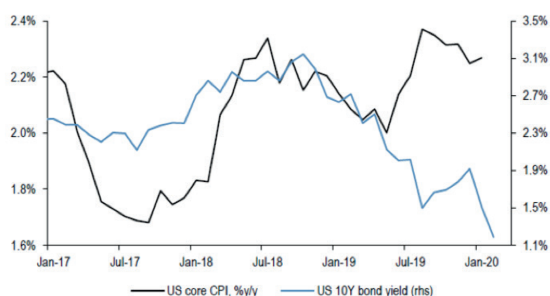
Macro data in the meantime are showing us that Yields are set to stay lower. The latest Chinese PMI print (the only one worldwide showing already the virus effect and showing the lowest level ever on non-manufacturing) is in line with US 10Y yields below 1%, the lowest levels in 150 years!

WORLD MANUFACTURING PMI (WHITE) VS US 10-YEAR YIELD (BLUE)



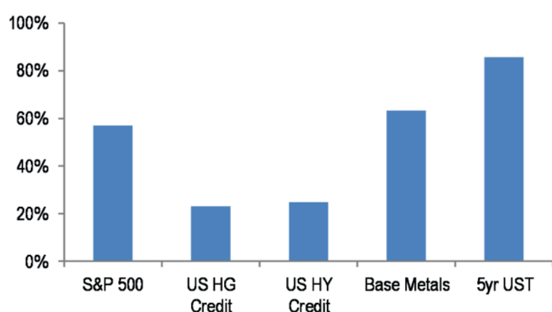
Inflation should also continue falling along with yields.

US CORE INFLATION (BLACK) VS US 10-YEAR YIELD (BLUE)



The market is therefore already pricing a US recession probability and rate markets are implying a higher than 80% likelihood scenario.

MARKET IMPLYING PROBABILITY OF US RECESSION FOR DIFFERENT ASSET CLASSES



As far as Equities are concerned, we would therefore still keep a prudent stance, at least until we will better understand the entity of the protracted hit from the global virus outbreak in Europe and US. As far as Fixed Income is concerned, we already started to reduce bond exposure in a multi asset portfolio as the risk-reward trade-off is no longer as favorable as it was, especially on corporate credit exposure.

Like in December 2018, last week Wall Street banks recorded 4 straight days without any high-grade bond offerings, with credit spreads widening substantially. That's the sector on which we are mostly worried about, as it could potentially generate a serious risk off which will as usual further expand to other asset classes in order to create liquidity.

In addition to the virus developments, we should be looking at the US elections events, Brexit lingering execution risk as negotiations have started not in a such positive way and new Trade wars looming on the global economy.

A complicated and volatile geopolitical landscape has added further complexity to investors' decision-making and a potential near-term reduction of geopolitical uncertainty wouldn't negate concerns around the increasingly late cycle nature of the global economy and more risks of a spate of further earning downgrades.

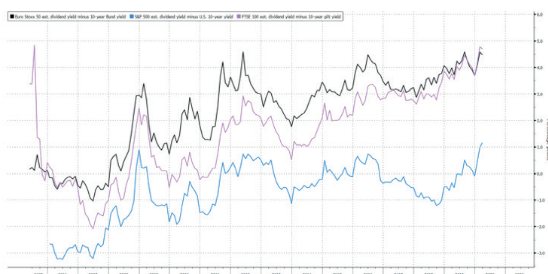
Let's now analyze **the current positive vs negative factors for the market** (please note that these factors are not all comparable in terms of timing, some factors are short-term while others mid to long-term oriented):

POSITIVE FACTORS (7):

- **Attractiveness of Equities (There is No Alternative)**: as flagged several times, there is still a massive amount of liquidity on the market. Negative-yielding debt makes up 25% of global debt, with the Euro area driving the most recent rise in negative-yielding assets. Even if you consider a decent cut, especially for commodity-related stocks, dividends would still be more attractive than Bond yields.

The earning yield on SXXP (Eurostoxx 600) is above 7% and dividend yield alone is 3.7%, the S&P 500 dividend and buyback yield is at 5.3%, vs the 10-year US Treasury's yield below 1%.

EUROSTOXX DIVIDEND YIELD MINUS 10Y BUND (BLACK), S&P DIVIDEND YIELD MINUS US 10Y (BLUE), FTSE100 DIVIDEND YIELD MINUS 10Y (PURPLE)

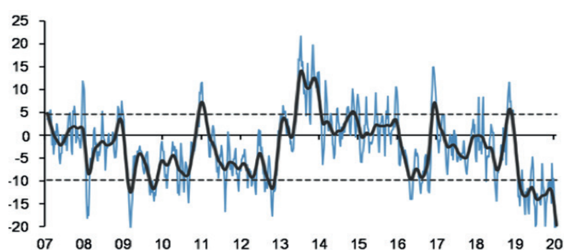


The dividend yield on the S&P500 is now above 100bps higher than the 10-Year Treasury yield, which was only above 1% for a brief period in December 2008 during the Financial crisis.

In Europe, almost 90% of European companies have a dividend yield higher than corporate bond yields, while in US the same percentage accounts for 60%.

At the same time, the difference between Equity versus Bond fund flows has reached a new low and could possibly reverse during 2020.

EQUITY VS BOND FLOWS



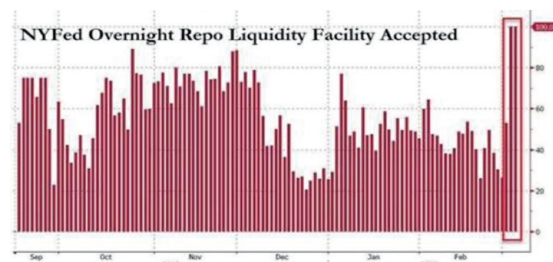
- **Central Banks stabilizing global growth** and sustaining equity markets. Global Central Banks are having the most synchronized global easing cycle in a decade with the majority of Central Banks participating and the market is expecting further potential unconventional measures down the line.

As already discussed, the actual combined effect of FED, ECB, PBOC and BOJ since October is very powerful and is helping the markets.

The emergency cuts we have seen this week are good for the short-term sentiment but it is yet to be seen any effect on Macro. The US Congress and the Administration are likely to act too, with stimulus in the form of tax cuts (a payroll tax holiday is quick to do; cutting employee taxes to zero for a year would boost GDP by about 1%) and higher spending on healthcare and support for small businesses.

Both last Tuesday and Wednesday the Fed announced that its first term repo operation for the month of March were massively oversubscribed, a record $108 billion, with the submitted to accepted ratio soaring to a record 3.5X, the highest since the launch of the Fed's term repo operations in September confirming that there is still a problem in the short term funding market.

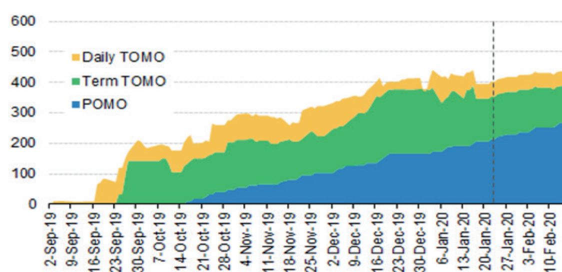
LATEST OVERNIGHT REPO ACCEPTED



Private and confidential - For professional investors only - Not for distribution

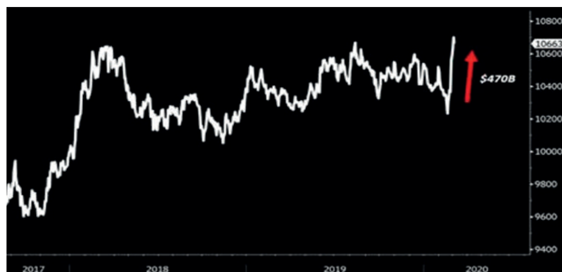
Since the Fed has rarely expanded its balance sheet at the pace it has been on, since October, there is limited history to analyze, but we found some evidence that periods of balance sheet expansion have lined up with above average equity returns.

CUMULATIVE FED LIQUIDITY ADD IN BILLION $



Money markets are currently pricing 100% probability of 10bps deposit cut by the ECB and the following chart shows how the ECB & BOJ together have added $470 billion to their balance sheets in the last 20 days!

ECB + BOJ (JAPAN) BALANCE SHEET ASSETS

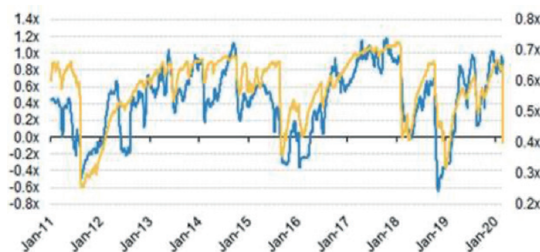


We believe that in the worst-case scenario, where tens of millions of people catch the virus, these measures won't prevent an economic meltdown but if infection is kept under control, the combined monetary and fiscal measures are meant to keep the economy out of recession.

- **Market positioning starting to be interesting again**.

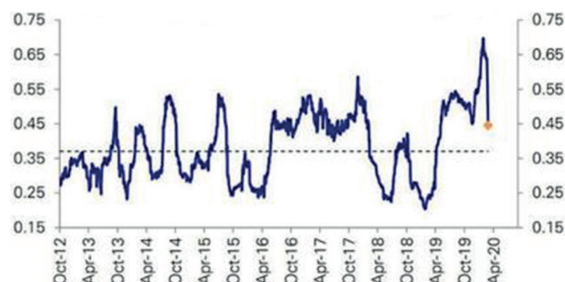
As we warned over our last newsletter, Volatility Target funds and other Systematic categories were fully invested and any spike in volatility would have caused a quick sell-off on equities. How the markets have corrected is known and volatility had the highest weekly spike in history. Those categories of investors are now in a completely different shape both in performance (from up 10% at the beginning of February to -4% now) and positioning. Vol Target are now invested at the 7th percentile (yellow line on chart) along with other Systematic categories. CTAs are instead slower to react and are continuing to sell now.

VOLATILITY TARGET, SYSTEMATIC, CTAS POSITIONING



Risk Parity fund equity exposure is down from a record high but might continue to reduce as the big chunk has been already adjusted.

RISK PARITY BETA TO S&P500 (BLUE)

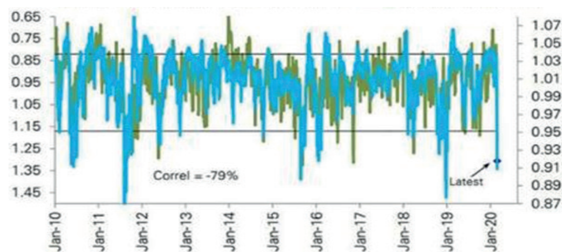


On aggregate, consolidated equity positioning has gone from extremely overweight (95th percentile) to very underweight (12th percentile) in very little time as shown below.

CONSOLIDATED EQUITY POSITIONING

Protection premium across asset classes has shot up massively and the cost of buying protection now is the highest we have seen over past years.

PUT/CALL VOLUME RATIO (INVERTED, 5-DAY MA) VS S&P500/50D MA (BLUE)



Short interest in the Spyder ETF have reached the highest level since June 2014.

SPYDER ETF SHORT INTEREST (WHITE)

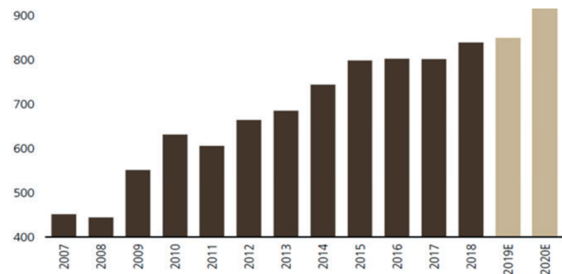
- **Buybacks should continue to support markets in 2020**: buybacks have been a key theme throughout this cycle with S&P500 companies returning $5 trillion to shareholders since 2009 and contributing in 2019 with 2.5% yield in US and 0.5% in Europe.

After the market sold-off and the blackout corporate period was over, companies bought at a very steady pace with demand highly concentrated on Tech sector (i.e. the pace of Wednesday was at 2X vs 2019 average).

This week, the blackout window is ending for most of the market cap of S&P500. This should mitigate some of the market's move.

In the chart below we can see the projected pace expected for this year. Interesting to note that, the repurchasing had reached the slowest pace in 18 months over the last 4 months.

BUYBACK PROJECTED PACE IN $



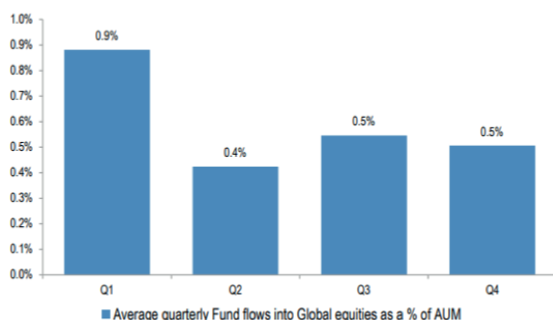
- **US elections**: the surprisingly strong result by Joe Biden in the democratic primaries last Tuesday are to be considered a significant positive development for the market as it likely removes the possibil-

ity of a far-left candidate, a risk that we had until Tuesday. A centrist democratic president would likely be positive for the market for reduced Macro volatility (trade wars, market volatility, uncertainty for businesses, etc.) likely more than offsets the potential increase of corporate and individual tax rates. Until few days ago, Sanders appeared highly likely to get the nomination secured with odds as high as 65%.

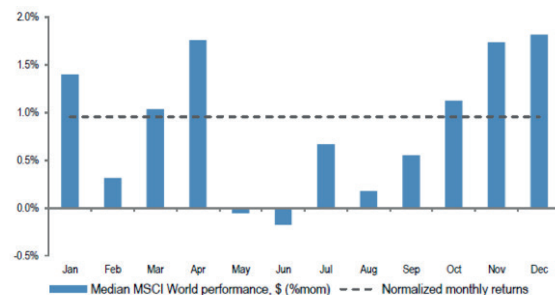
It is however still possible that none of the Democratic contenders will win a majority of the 3,979 pledged delegates needed to clinch the nomination on the first ballot, triggering a contested convention in July, a potentially chaotic process that Democrats haven't had to undertake since 1952.

- **Seasonality**: looking back over the past years, markets were up most of the time into US elections and over the last 20 US election cycles, there have been only two instances of the markets down in the 12 months leading to the election results. On top of that, inflows into equities tend to be higher in Q1 when compared to the rest of the year and March/April are generally two very positive months.

AVERAGE QUARTERLY FLOWS INTO GLOBAL EQUITIES



MEDIAN MONTHLY MSCI WORLD PERFORMANCE



- **US housing getting more bullish**. The US housing market is continuing to accelerate across a number of the national metrics we are tracking. Robust demand and tighter supply are aided by better affordability, leading to accelerating HPA, increasing existing and new home sales, and climbing single-family housing starts.

The recent cut in rates is further increasing the affordability. This is in contrast to the view we had last year.

Buyers snapped up new US homes over the past three months at the fastest pace in more than 12 years, adding to signs of sturdy housing demand amid lower prices and borrowing costs. New York is currently seeing the biggest home-building boom in years, the highest pace since 2015 which reflects a strong optimism in the American economy.

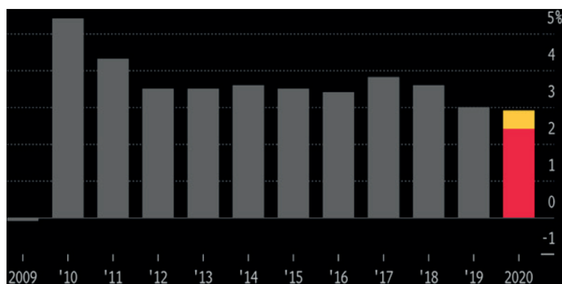
NEGATIVE FACTORS (8):

- **Technicals**: over our last monthly newsletter and daily comments, we have been highlighting several technical indicators that have successfully called for a market correction. They have worked very well and the current situation is not yet stabilized to generate a positive medium-term

signal. A short-term bounce was expected but in order to have a better entry signal we will need some form of stabilization which is not on the cards yet. CTA funds which tend to follow medium-term signals and crossing averages are very close to turning from long to short if the market doesn't bounce further over the next days.

- **Macro deteriorating**: as we discussed above the virus effects will be tangible on worldwide economies and the entity of the effects is of course still unknown. Brokers have already started to lower their estimates and now we are getting some revised numbers from the IMF saying that the virus will wipe out any hope of stronger growth in 2020 as they expects 2020 world growth to be below the 2.9% rate for 2019, and revised forecasts will be issued in the coming weeks. The OECD has also cut its outlook for 2020 global growth to 2.4%.

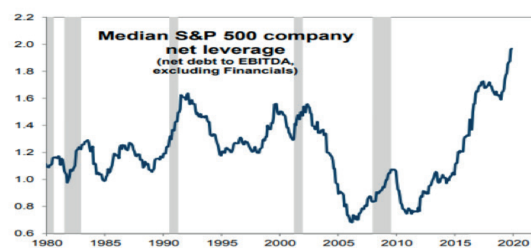
ANNUAL GLOBAL GDP (GREY) VS OECD PROJECTION (RED) VS PRIOR OECD FORECAST (YELLOW)



- **Valuations are slightly less expensive but Economic momentum shifting downwards**.
Thanks to a staggering sell-off, the S&P500 has de-rated from 19x forward P/E multiple, where was trading at the beginning of the year, after we saw the second largest multiple expansion for global stocks last year since 1988. Only 2009 saw it larger.

The median S&P company net leverage has reached a new record.

RECORD CORPORATE LEVERAGE RATIOS



Morgan Stanley widely followed proprietary US Cycle Indicator model has predicted the beginning of the downturn for the 1st time since 2007 already 6 months ago. This phase-change has historically meant a worse backdrop for returns and higher chances of recession or a bear market in the medium to long term horizon.

US CYCLE INDICATOR

- **Lack of volume and market breath**. 2019 delivered fresh reminders of the fragility of fixed income market microstructure and over the last days we have witnessed even better how vulnerable in-

vestors are with current deterioration in market liquidity.

On the Eurostoxx the bid/offer spread last week rose from 3bps to 5bps and on the SCXP (Smallest name within the Eurostoxx 600) the spread has increased from 9bps to 12bps. This is the largest increase since 2012!

At the same time, the order book (available size in the book made of bid/offers) has gone 40% thinner than the 6-months average.

TOP LINE OF ORDER BOOK – SX5E FUTURES (BLUE) AND CASH (GREY)

We are therefore witnessing very difficult and costly trading conditions than we have seen in the past.

- **IPOs & Private Equities**. Investors had extremely difficult time stomaching big IPOs throughout 2019. While we had seen record supply in Corporate Bond issuance recently, the supply on the equity side was relatively light and after the sell-off they have been all postponed along with secondary placings.

It is not reassuring to see what is the proportion of US IPOs that are lossmaking with only 25% of those names that are profitable during the 1st year, the smallest over the last 20 years when the average was 51%.

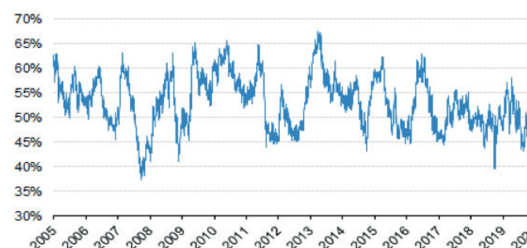
PROPORTION OF US IPOS THAT ARE LOSSMAKING

At the same time, in the Private Equity industry, the share of capital going to companies not categorized as profitable has increased to an all-time high. This could be dangerous considering that Private Equities are normally using a leverage of 3x to 4x.

- **Passive bubble/ETFs?**
We started warning over our last newsletter about the potential passive flow "bubble" with just 5 US firms composing an amazing 18% of the S&P's market cap. We shouldn't be surprised if Apple and Microsoft alone count for 15% of the upward move of the S&P in 2019!

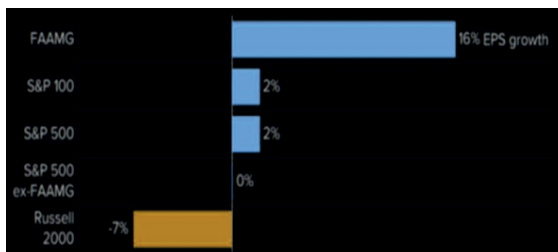
No wonder why the breadth on the S&P over the past 6 months has been the narrowest since at least 2005 with only 38% of the S&P constituents outperforming the index.

S&P500 BREADTH



S&P earning growth is coming from just 5 companies: Facebook, Apple, Amazon, Microsoft, Google.

Q4 2019 EPS GROWTH YOY



The Federal Reserve explains that passive funds in 2018 now account for 39% of the combined US Mutual Fund and ETF assets under management, up from just 3% in 1995 and 14% in 2005. According to the paper, passive investing is pushing up the prices of index constituents and there is a risk that rising prices can lead to more indexed investing, and the resulting "index bubble" eventually could burst.

We tested how these ETFs flows work even the downside and most of the record-speed correction was due from quick sell orders on ETFs. It is worrying to think that the largest market cap stocks that are held within ETFs, represent more than 30 days of the average daily trading volume of the individual security that is traded on the exchanges. This means, for example, if only 10% of ETF holders decide to sell the security on any given day, it will represent three times the entire volume that is traded on the NYSE. Therefore, what we have is a condition where investors have become overcrowded in a few positions, just like what has occurred in previous market tops. In 2008 there was just $700 billion invested in ETFs, today we are at $5 trillion.

- **Concerns on US consumer**: Nominal growth of consumer spending in 2019 has slowed to its weakest growth rate in three years, with many traditional retailers seeing no growth in top-line sales and with the virus spreading we have already seen how heavy effected are consumers business in those areas.

As US Consumer confidence data is heavy correlated with the US Indexes, we would expect a substantial fall over the next weeks just as it reached the 20-year high last month.

On the surface, the growth of consumer borrowing is not excessive, but what is excessive is how much it costs consumers to borrow. Personal loan rates at commercial banks stand at 10%, and average credit card rates stand at 17%, at 25-year highs. In 2018, the percentage of people that would cover $400 of emergency expenses using a credit card has increased to 61% from 50% in 2013. In short, rising interest expenses are drying the "spending power" of the consumer. At the same time, it is important to note that US consumer credit-card delinquencies, the precursor of charge-offs, rose to a 16-year high among smaller commercial banks. Federal Reserve data show that delinquency rates (those that are 30 days past due) climbed to 6.3%, double the level of three years ago and Auto Loans delinquencies have reached a 7-year high.

TOTAL PUBLIC & PRIVATE DEBT AS % OF GDP

Private and confidential - For professional investors only - Not for distribution

- **Bond bubble?** We started the year with a record increase in issuance volumes which has started to put some strains on Credit spreads even before the correction started. Sales of new bonds in Europe have slowed dramatically following the best-ever start to a year, as the spread of the coronavirus shutters markets. Just four deals have surfaced this week, with a flight to quality evident. In January we had a record $238.8 billion of sales and a strong start to February, when weekly sales averaged more than €44 billion until last week.

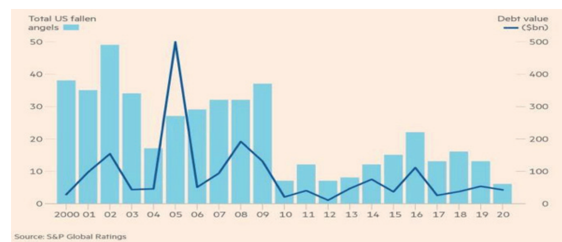
Over the last 10 months, global debt surged by $7.5 trillion, of which China and US accounted for 60% of the increase (US deficit to increase further).

The IMF recently warned that $19 trillion, almost 40% of global corporate debt are at risk of default in case of a massive crisis. US Junk-bond yields just few weeks ago have hit a new post-2014 low at 5.08%, just 25bps away from the all-time low of 4.83%.

We have expressed several times our concern about the BBB rated debt which accounts for 60% global Investment Grade (was 38% in 2009 before the crisis), as much as twice of Junk rated bonds. The difference between BBB and BB US corporate bond spreads collapsed further as investors continued chasing yield in the highest-rated junk bonds. The compression is making it, such that investors may have to start reaching even further down the ratings spectrum to find value.

Currently there are 26 US BBB issuers (out of 198, so 13%) with high gross leverage above 4x which is traditionally reserved for junk bonds. Year to date, $6.8 billion of market value has been downgraded from IG to HY ("fallen angels"), in just 2 months we have nearly reached half of last year's total.

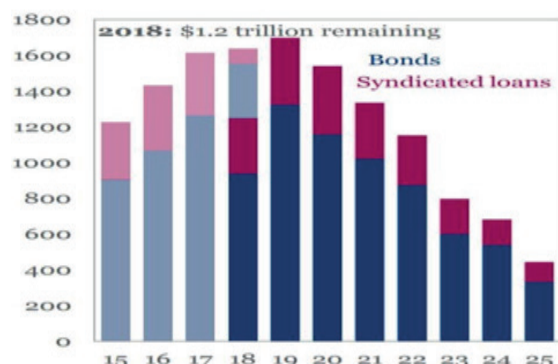
DEBT VALUE IN $ BILLION (BLUE LINE) VS TOTAL US FALLEN ANGELS (HISTOGRAM)



Junk bonds with the lowest rating, particularly in the energy sector, are on a one-way street down as global markets deteriorate. The spread on CCC rated junk bonds jumped above 1,000 bps over the last days and this is the level that typically implies distress.

With $1.5 trillion in USD denominated debt maturities in 2020, emerging markets will face a massive credit threat as commodity prices and export volumes are collapsing.

EM DEBT MATURITY PROFILE $ BILLION



China's most stressed dollar debtors face a major test of their financing capacity, with over a tenth of all bonds coming due just as the nation grapples with the economic impact of the coronavirus. About $2.1 billion of offshore notes with yields of at least 15% (characterizing them as stressed) are due in March, the biggest monthly maturity wall this year. Most were sold by property developers, an industry that's been hard hit with China's transport system hobbled and much of the economy in an effective lockdown in recent weeks.

CHINA DOLLAR BONDS YIELDING AT LEAST 15%

Trade Ideas

CURRENT CONVICTIONS

Put spread on Indexes
We have been suggesting on our daily updates the purchase of cheap Puts on Indexes at the beginning of February and, since then, volatility has really exploded.
We are now suggesting the purchase of Put spread as a good way to protect portfolios but of course the upside is limited compared to a naked Put.

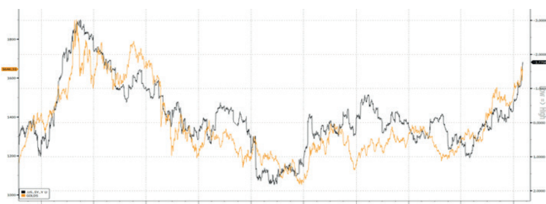
Long Gold
We have been successfully suggesting to increase Gold positioning since October 2018 and is now up 35% from those levels but we recently explained how it would have been more volatile and riskier compared to the previous months.

The reason being it is now a consensual long position and the price/action shows it all. It didn't really protect from the market downside.

Gold futures has registered a steady build in new longs from mid-December and gold holding ETFs rose to the highest level since January 2013.

The correlation between Gold price and Real Yields is at the moment the main source of upside.

GOLD (YELLOW LINE) VS US 5Y REAL YIELD (INVERTED)



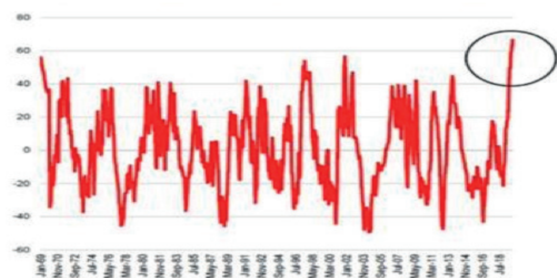
Central Banks

Central Banks have pumped an enormous amount of liquidity into the markets and will continue to do so over the next months, possibly at an even higher pace. The chart shows the green line, global liquidity, currently at almost $82 trillion, a record level for Central Banks.

It's very clear that more and more Governments are adopting expansionary fiscal and monetary policies in unison, a sort of "whatever it takes" approach to sustain cross-asset valuations and calm market volatility.

GLOBAL LIQUIDITY (GREEN) VS S&P500 (BLUE)

12-MONTH CHANGE IN US FED LIQUIDITY INDEX

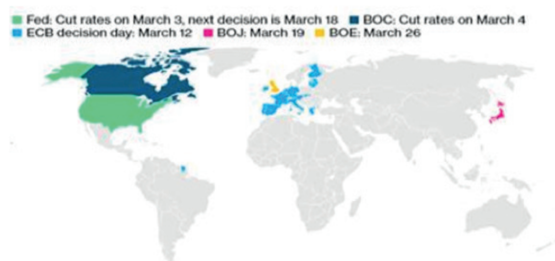


Central Bank activity has been pretty intense over the past few weeks. Among the main reasons, a) Macro numbers getting awful due to Covid-19 crisis, China's lockdown, global supply chain and international trade disruptions b) Money markets pricing further easing, pushing Central Banks to cut rates, and record-low interest rates c) Equity market melting down with high intensity and record-speed d) rising asset volatility e) short-term funding issues.

We wrapped up the latest and most important Central Bank actions in the chart.

So far, the Fed and Bank of Canada cut rates, while some next events are ECB due on March 12, BOJ (Japan) due on March 19 and BOE (England) due on March 26.

CENTRAL BANK G-7 POLICIES



The Fed unanimously cut the Fed Fund rate target by 50bps to a target range of 1% to 1.25%. The intervention was provided with an emergency cut that was meant to improve the short-term sentiment (the market lost 3%) but it yet to be seen any effect on Macro. Interesting to note that the latest emergency cut was in October 2008 and even if circumstances were more extreme, it didn't really have any positive impact on markets.

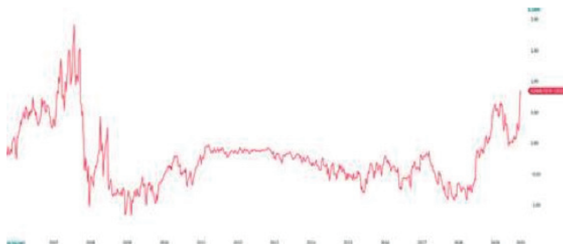
Money markets forced the Fed to act and Powell delivered.

3-month Libor plunged to 1.25%, the most since 2008. 2-year Treasury yield fell to 0.6%, multi-year lows. 10-year Treasury yield went below 1% for the first time in 150 years and the spread between the Fed fund rate and 2-year yield jumped up to the great financial

Private and confidential - For professional investors only - Not for distribution

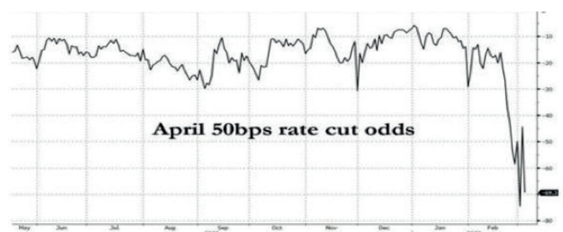
crisis level, 83bps vs a negative spread in 2019, before the Fed intervention (chart).

FED FUND RATE-YEAR VS 2-YEAR TREASURY YIELD SPREAD



It's very impressive to see that money markets are pricing 50bps Fed Fund rate cut in April with 70% probability (chart).

FED FUND RATE CUT PROBABILITY IN APRIL



It might be possible that we will see negative yields in the 2- and 3-year sector of the US Treasury curve in the short/mid run. Further, we might even see the 10-year Treasury down to 0% (now 98bps) and of course an additional Quantitative Easing (which would be added to the current Not-QE).

Also, money markets are currently pricing 100% probability of 10bps deposit rate cut to -60bps by the ECB, up from 80% some days ago.

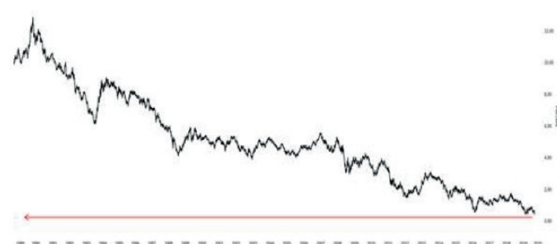
Other expansionary measures might include a new QE wave (in addition to current $20 billion per month) or a new TLTRO. The chart shows the ECB measures currently in place.

**ASSET PURCHASES, QE (GREEN) VS ECB BALANCE SHEET TOTAL ASSETS (BLUE)
DEPOSIT RATE (YELLOW) VS TLTRO (RED)**

Interestingly, looking at the move of UK 10-year bond yield, it might be possible that the BOE (England) will need to proceed with an emergency cut rate. As you can see below, UK 10-year yield, are hovering around all time-low, 0.33%.

As with the Fed, the market is pushing the Central Bank to cut as soon as possible. Money markets expect at least two rate cuts by the end of the year.

10-YEAR UK YIELD



Macro

Global growth weakened considerably in February. The global manufacturing PMI plunged to 46.7 from 50.2 in January, the steepest contraction since 2009, snapping a three-month streak of expansionary readings. Of the 31 nations for which February data were available, 15 registered a contraction of output, including China, Japan, Germany, France, Italy, Taiwan, South Korea and Australia. Global disruption to supply chains and international trade along with the halt of Chinese production hit the global economy. In addition, in February, global new orders registered their sharpest decline since 2009 while global supplier delivery times lengthened substantially. Not surprisingly, output and new business fell at survey-record rates in China.

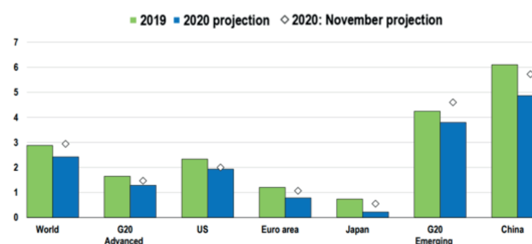
GLOBAL PMI OUTPUT INDEX (GREEN) VS GLOBAL MANUFACTURING PRODUCTION

However, it's not all doom and gloom. Although no one can know the length and the long-standing effects of this plague, it seems that, so far, the global ex China Manufacturing PMI (excluding China's effect) held up quite well in February. If the crisis is contained, we will see a V-shape recovery in Macro numbers.

EX-CHINA GLOBAL MANUFACTURING PMI (BLUE) VS NEW ORDERS (YELLOW)

The OECD is the first international institution to provide a forecast on global economy post-coronavirus. According to its best-case scenario, global growth is set to increase by 2.4% in 2020 vs previous 2.9%. This would mean roughly $400 billion loss for the global economy. According to its base-case scenario, global growth would slow down to 1.5% in 2019 if the virus is not contained, while the worst-case scenario would see even lower growth if the plague spread to Africa, Latin America and India.

OECD GDP GROWTH % ESTIMATES



The global CAI (Current activity indicator), an alternative measure of GDP, tumbled to 1.3 point, the lowest level since June 2009. According to the latest numbers, inflation seems to be stable in Developed markets. Importantly, the impact of coronavirus is still uncertain and will depend on the spread of the virus, containment measures, and disruption to production.

GLOBAL CAI (CURRENT ACTIVITY INDICATOR)

Europe

After improving for several consecutive months, numbers came weaker in February. Though, we have not seen the full effects of coronavirus yet. A significantly larger and more protracted hit is due, stemming from lower export demand, more pronounced supply chain disruptions and weaker domestic demand due to local infections. In particular the hit is likely to be more severe in Germany, with international exports plummeting and Italy, due to the infection outbreak and the related economic lockdown. Several economists see no Euro-area growth in Q1 2020 and between 0.25-0.4% drag in Q2 2020.

Negative

Feb Zew (survey) expectations/business conditions missing, very low level

Euro-aggregate new car registrations down to -7.5% from 22% prior (multi-year low)

Germany, Euro-area Service/Composite PMIs missing

USA

Same story here, after a strong January, data considerably decreased. And again, China's lockdown full effects and other disruptions have not been taken into account yet. Much lower US goods exports to China, a decline in tourist arrivals from China, and supply chain disruptions affecting US retailers will definitely weaken the American economy in the next quarters. Several economists see US growth at 1% in Q1 (January CAI was at 2%), with the virus shaving off more than 1% of GDP in the whole 2020 YoY.

Negative

Feb Manufacturing, Services, Composite PMI missing consensus

Feb ISM Manufacturing, New Orders, Prices Paid, Employment all missing (biggest production drop since 2018 - imports index swung into contraction the lowest reading since 2009)

Feb Consumer confidence at 130.7 vs 132.2 consensus

China

The most affected region with terrible data in February. China CAI (Current activity indicator), alternative measure of GDP, is tracking -1.5% in February from 6.1% in January. Interestingly, February PMIs were the lowest ever recorder with imports, exports and new orders at very weak levels. All measure we are currently tracking show production, consumption, pollution, traffic and travelling are still well below normality.

Negative

Feb Manufacturing PMI at 35.7 vs 50 prior (50 expansion, the lowest reading ever)

Feb Non-Manufacturing at 29.6 vs 51.1 prior (the lowest reading ever)

Feb Caixin Composite at 27.5 vs 51.8 (the lowest reading ever).

CHINA CAI (CURRENT ACTIVITY INDICATOR)

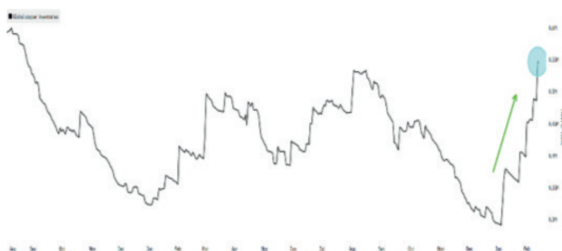
Private and confidential - For professional investors only - Not for distribution

Commodities

The recent Equity market sell-off along with the sharp risk-off move in Fixed Income, smashed Commodities valuation even further. After several weeks since the outburst of the virus crisis and the related Chinese lockdown, we have probably seen the largest disruption to commodity-related activity since 2008, with China-dependent assets experiencing immense headwinds. Taking into consideration weakened global growth, lower demand and international trade expectations, <u>we would reiterate our neutral stance in the short run in order to assess future developments</u>.

Since our last update, 07/02, the Bloomberg Commodity index is down almost 2%, coming off some 11% from January highs and more than 20% from 2018 highs. Energy, Livestock, Industrial Metals and Agriculture declined double digits year-to-date. Among precious metals, gold rose 8% year-to-date buoyed by uncertainty and central bank activities.

COPPER INVENTORIES



Interestingly, global copper stockpiles surged to 2018 highs (economic bellwether), confirming the massive slowdown of the global economy.

Since the outburst of the virus the Bloomberg Commodity Index lost 11% with a max drawdown of 14% (red mark in the chart). Among its main detractors year-to-date (index weight order): Natural Gas -18%, Copper -8%, WTI -22% and Brent -20%.

BLOOMBERG COMMODITY INDEX

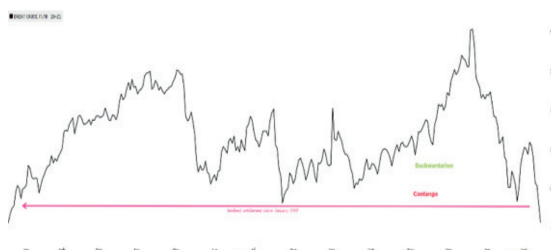
Oil

<u>We reiterate our neutral position on the asset class.</u>

Since our last update, WTI and Brent are down roughly 5% after falling 27% since January highs. We are definitely seeing more issues on the demand rather than the supply side.

Oil is currently trading close to oversold levels, with Brent December20/21 back into Contango, the weakest settlement since January 2019 (chart).

BRENT CRUDE DECEMBER20/21 CONTANGO

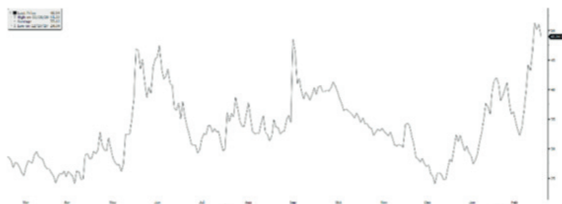


We might also see a rally in the short run, as WTI often gets its best returns after its skewness has been the most negative. Options skewness has proven to be somewhat of a contrary indicator of near-term price direc-

tion over the past decade.

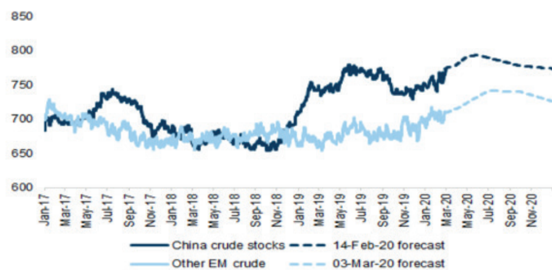
Brent and WTI put skews reached the most bearish since June 2019. Oil volatility is close to multi-year high (chart).

WTI VOLATILITY



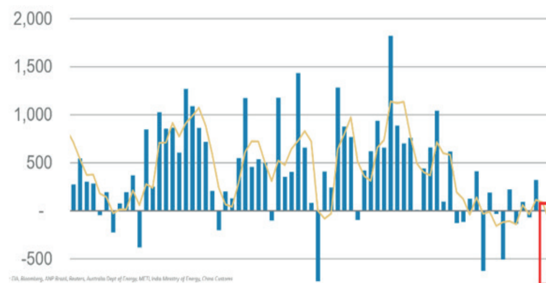
The point here is that even with the additional OPEC+ cuts, we might see a large oil inventory accumulation. As we expected, China crude inventories are rapidly rising with builds now expected to start in other EM countries. In addition, recent US crude inventories (EIA) rose the most for the sixth straight week, confirming that there might be a supply gut.

CHINA CRUDE INVENTORIES (BLUE) VS EM INVENTORIES (LIGHT)



World oil demand growth (approximated by the biggest countries), fell by a large 620k barrel per day YoY in January. This was the largest decline since March 2019 and was led by Japan, South Korea and preliminary estimates for the US.

WORLD OIL DEMAND GROWTH YOY



In February, OPEC slashed its forecast for 2020 global oil demand to just 1 million barrels per day, down by 230k barrel per day from the previous month's estimate. Chinese oil demand is now revised down by 200k barrel per day in H1 2020 from the previous monthly assessment, resulting in an overall downward revision of 400k barrel per day in global oil demand growth in H1 2020.

Gold

Since our last update gold is up more than 4% mainly buoyed by Macro uncertainty, falling interest rates and dovish stance of global central banks. We continue to reiterate a strategic bullish allocation in the mid-long run.

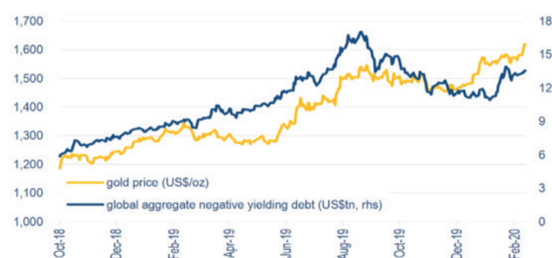
Year-to-date gold rose a staggering 8%, after having increased roughly 18% in 2019.

Interestingly, gold retraced more than 7% from February 2020 highs, from $1690 to $1560 per troy ounce at the beginning of March, as we correctly predicted, since investor positioning was getting more and more stretched (and we said so in our last newsletter). Check out the following chart with futures positioning getting extreme in February.

FUTURE GOLD POSITIONING

Then, in early March, money markets pushed the Fed to cut rates by 50bps, with 10-year US real interest rate plunging to -45bps, multi-year record low (remember it was positive in early 2020). In addition, the market is currently pricing another 50bps Fed Fund rate cut in April with more than 70% probability. This is pushing yields down, and remember the negative correlation between real US rates and gold. In the chart you can see the positive correlation between gold and the dollar amount of global negative yielding debt.

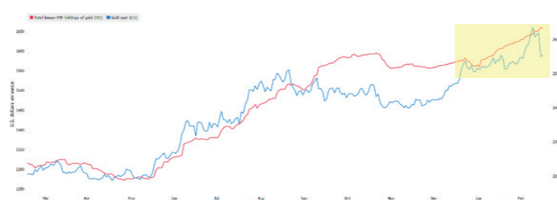
GOLD (YELLOW) VS GLOBAL SUB-ZERO YIELDING DEBT (BLUE)



Not surprisingly, the amount of global ETF holdings has jumped to fresh all-time highs, with year-to-date flows into gold-back ETF hitting over 100 tons, another record with the highest pace of expansion since September.

And remember that although Russia (holds 20% of its reserve in gold) and China have both reduced purchases, the amount of Central banks buying is still ongoing (expected to increase).

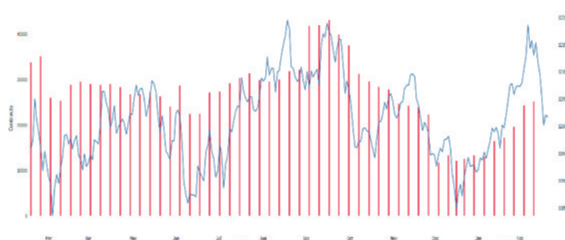
GOLD ETF HOLDINGS (RED) VS GOLD PRICE (BLUE)



Forex

The **USD Bloomberg index** rose up to 3% in the first 2 months of the year, along with futures positioning (chart), mainly buoyed by increasing uncertainty, to later slump roughly 1.5% on rumors of Fed cutting Fed fund rates and money markets pricing additional easing. Forex volatility jumped in March as well (chart).

USD FUTURE POSITIONING (RED HISTOGRAM) VS USD INDEX (BLUE LINE)



JP MORGAN GLOBAL FX VOLATILITY INDEX

The **EUR** jumped against USD almost 3.5% from mid February,with EURUSD hovering around 1.1160 level. This move has been mainly driven by dollar weakness on Fed easing expectations and a massive carry trade unwinding.

It seems that investors who were borrowing cheap euros to invest in riskier assets have been, amid the recent market turmoil, selling those assets to buy back euros and unwind their trades.

EURO-DOLLAR ONE-WEEK RISK REVERSAL

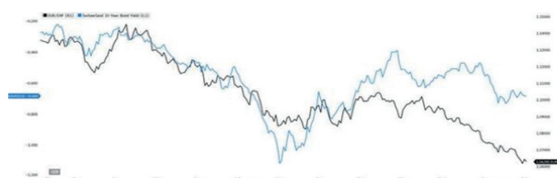
Also consider that the recent speculation of fiscal stimulus might have increased some appetite for EUR currency.

Interestingly, after reaching their most bearish sentiment for the Euro currency in five months a couple of weeks ago, risk reversals rally hard in favor of calls long Euro.

A euro-dollar one-year call with strike at 1.17 traded some weeks ago for €400 million. The chart shows the Euro-dollar one-week risk reversals, V-shaped recovery with Euro sentiment making a sharp turnaround.

The Swiss Francs is currently overbought under G10 Purchasing Power Parity and trading well above levels implied by its real-effective exchange rate.

EURCHF (BLACK) VS 10Y SWISS BOND YIELD (BLUE)



However, it's interesting to note that CHF appreciated roughly 2% vs Euro year-to-date due to its safe haven status and the intense Swiss bond bidding activity (chart).
10-year Swiss bond yield has decreased (Bond price up) while Francs strengthened.

Private and confidential - For professional investors only - Not for distribution

Disclaimer

This information has been issued by Colombo Wealth SA ("Colombo"). Colombo is an investment management company authorized and regulated by the Swiss Financial Market Supervisory Authority FINMA. Colombo performs its financial activities solely in Switzerland.

This is a marketing tool. This document has been prepared solely for information purposes and is intended for qualified investors only. Under no circumstances should the information contained herein, and/or this document as a whole, be used or considered as an offer to sell, or solicitation of an offer to buy any security, nor shall it be considered as a public offering of any securities. This document is intended for educational, illustration, commercial and/or discussion purposes only. This document may include information that is based, in part or in full, on hypothetical assumptions, models and/or other analysis. No representation or warranty is made as to the reasonableness of any such assumptions, models or analysis.

The information set forth above has been obtained from or based upon sources believed by Colombo to be reliable, but Colombo does not represent or warrant its accuracy or completeness. This material does not purport to contain all of the information that an interested party may desire. In all cases, interested parties should conduct their own investigation and analysis of the information presented and of the data set forth in the document. Actions or omissions resulting from the information contained herein are at the investor's sole risk.

Investing in financial products involves risks, including in particular those associated to market volatility and exchange rates fluctuations as well as the inherent risk of every product type. The value and the return may fall as well as rise and are not guaranteed. Past performance is no guarantee for future results and investors may not get back the amount originally invested

This document may not be reproduced in whole or in part or circulated to other persons without Colombo's prior written approval.

COLOMBO

Lugano | Zürich | Genève

Colombo Wealth SA

colombo.swiss