Weekly Report and Outlook on Global Markets

25th April 2020

South Africa's virus rescue package has bond investors on run

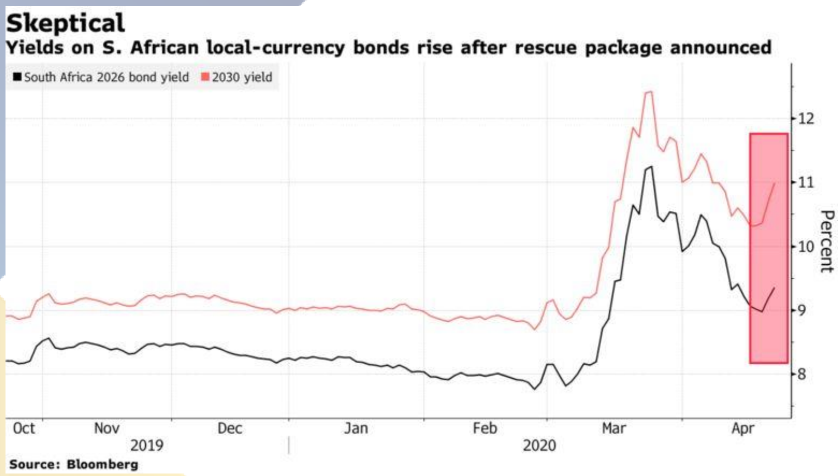

Figure 1: The chart represents Yield on South African local currency bonds

Investors aren't buying the South African government's assurance that it won't significantly increase debt sales to fund a massive economic rescue package. Yields on government rand-denominated bonds have climbed more than 50 basis points since President Cyril Ramaphosa announced the 500 billion rand ($26 billion) fiscal injection on Tuesday.

Even before a Covid-19 lockdown that is expected to shrink the economy by 6.1%, according to the central bank, South Africa was saddled with stagnant growth, rising government debt and a weakening currency that made the country's bonds less attractive to foreign investors. Moody's cut its credit rating to junk last month, which will result in an exit from the WGBI and other indexes that track investment-grade debt. Even before a Covid-19 lockdown that is expected to shrink the economy by 6.1%, according to the central bank, South Africa was saddled with stagnant growth, rising government debt and a weakening currency that made the country's bonds less attractive to foreign investors

Japanese Insurers looking to tap overseas corporate bond market

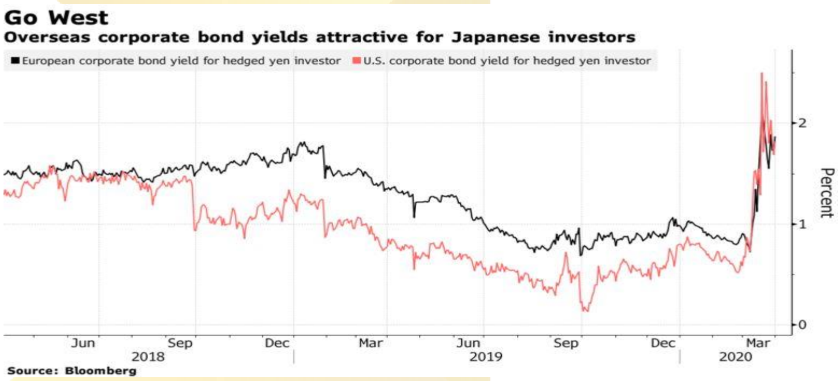

Figure 2: The chart represents European and American bond yield for yen hedged investors

Buying corporate bonds overseas is emerging as the top strategy for Japan's life insurers, as they look to beef-up returns in a world of depressed sovereign yields and mounting stock losses.

The Fed's move to include high-yield bonds in its purchases has sparked a rally in credit markets this month. The spread between corporate and government bonds has widened as global central banks keeps sovereign yields at multi-year lows to combat the coronavirus pandemic.

Four of them, including the biggest players Nippon Life Insurance Co. and Japan Post Insurance Co., plan to boost their holdings of foreign credit with currency hedges in the fiscal year that began April 1. Most have a preference for investment-grade debt in the U.S., followed by Europe.

US debt to surpass WWII levels

The U.S. budget deficit may quadruple this year to almost $4 trillion (Projections from the Committee for a Responsible Federal Budget (CRFB)). These projections only include spending enacted so far—in a three-month-old crisis that has seen emergency Congressional appropriations top $2.3 trillion. Additional spending is almost certain as the coronavirus pandemic destroys millions of jobs and thousands of businesses while slashing tax revenues for local and state governments.

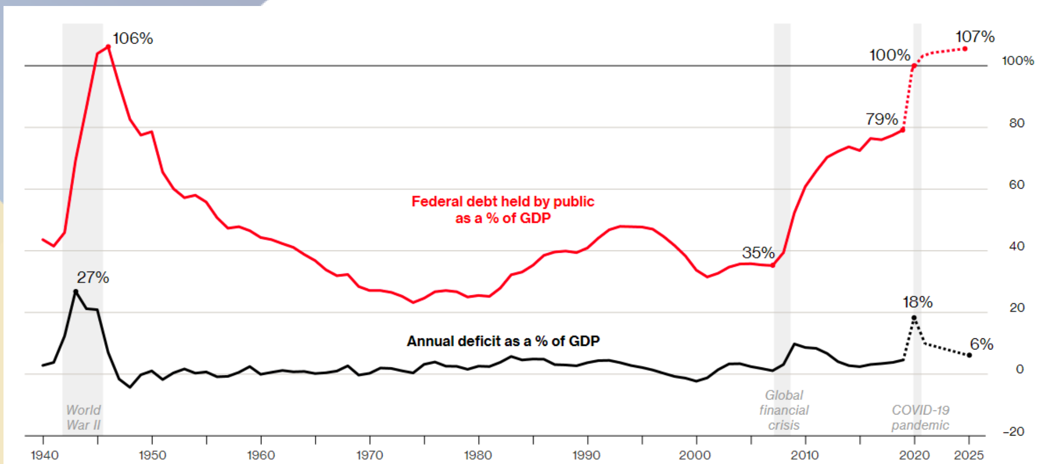

Figure 3: Sources: Committee for a Responsible Federal Budget, Congressional Budget Office, Bloomberg data

Even before the crisis, U.S. debt-to-GDP had more than doubled to 79% in 2019 from 35% in 2007. Deficit hawks, already hard to find, disappeared once the virus shut down whole swaths of the U.S. economy. The Coronavirus Aid, Relief, and Economic Security (CARES Act) legislation passed on a unanimous voice vote. Lawmakers understood that frugality made no sense in the face of impending economic collapse.

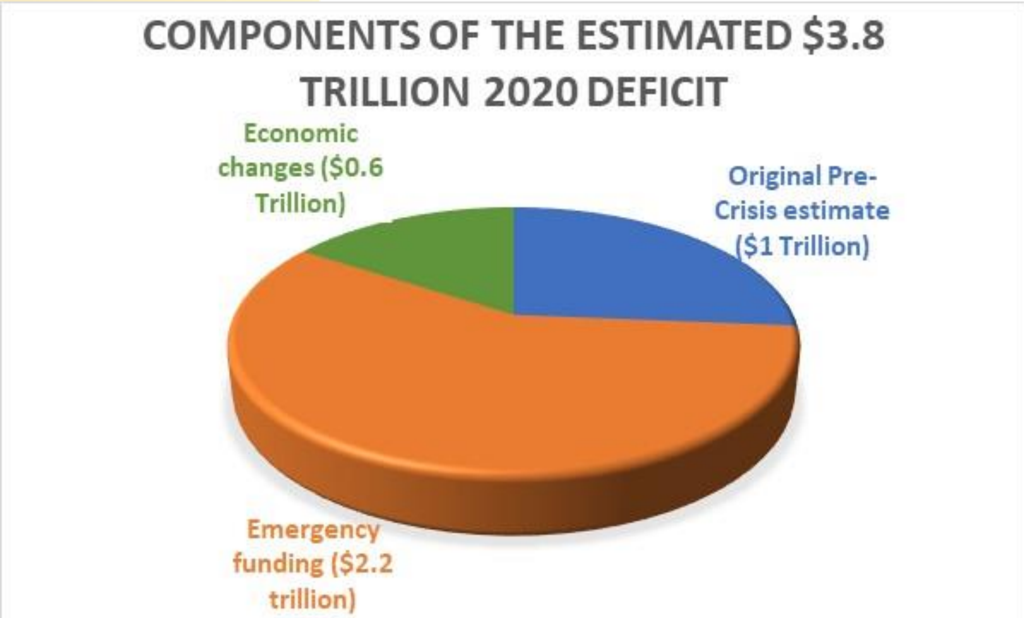

Figure 4: Sources: 2020 Deficit Sources: Committee for a Responsible Federal Budget, Congressional Budget Office, Bloomberg research

Not all the stimulus is gone for good. About 20% of the CARES Act spending, $454 billion, will be used to backstop lending from the Federal Reserve—possibly more than $4 trillion.

In a worst-case scenario, the CRFB predicts debt could reach 117% of GDP by 2025, easily exceeding the record of 106% set in 1946. That won't represent an immediate threat because interest rates are so low. The Treasury can borrow cheaply. The challenge will be to rekindle the economy so that, like after World War II, the debt can be conquered through growth instead of austerity. But should inflation awaken from its long slumber and force interest rates higher before growth revives significantly, the weight of rising debt could become crushing.

MAJOR MOVES THIS WEEKS

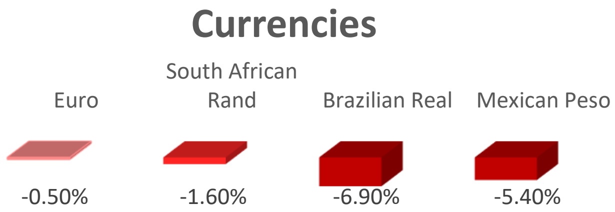

Figure 5: The bar graph represents Currency returns with respect to US Dollar as the base currency for this week

Most of the currencies this week ended on a flat note against dollar. Though there was volatility throughout the week in some major currencies like Russian Ruble, Euro, Pound, Australian and New Zealand Dollar, and South African Rand, they closed near to previous week's closing. Brazilian Real continues its downtrend due to increasing bets on further rate cuts and political turmoil prevailing in the country whereas Mexican Peso also continues its downtrend due to recent credit rating cuts, fall in crude oil prices and bets on further easing of policy

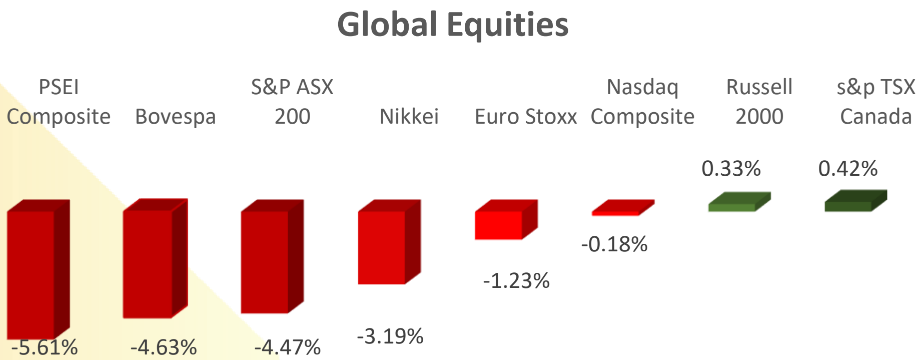

Figure 6: The chart represents the equity index returns over this week.

The emerging market equity indices fell the most this week while the developed market indices such as S&P 500 and euro stoxx did no take a similar beating. The US small cap RUSEELL 2000 index held ground when compared with the large caps most of the movement in the upward direction was seen in the defensive sectors.

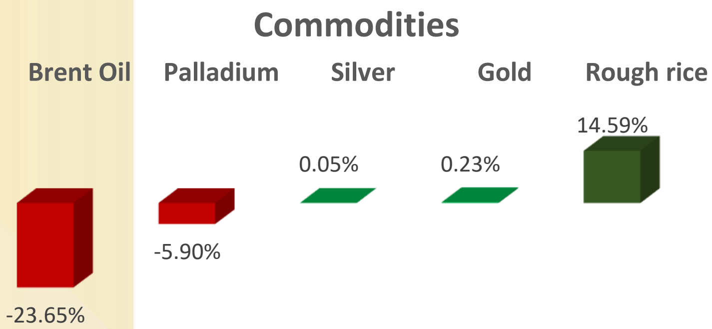

Figure 7: The chart represents the commodity futures returns over the week.

Crude prices collapsed on Monday as the futures contract's delivery date came close and investors wanted to get rid of their positions as there were no storage spaces available. The demand shock also resulted in plummeting of the crude oil prices. Precious metals such as silver, gold held their ground. A winner this week in commodities was US rough rice futures.

GLOBAL FUND MANAGER’S STATEMENTS

1) Carl Icahn (Co-founder, Icahn Enterprise) on interview with Bloomberg Television :- “I expect to see some good opportunities amid the sell-off however, in the short term we could still see some big downdrafts. I think the virus can return in "spurts and people will not be as enthusiastic about returning to normal life while the threat of a deadly disease lingers. Today the risk is too high for the reward in many companies and many Tech stocks are overvalued. I have a bet against an index of commercial real estate debt that will pay off when large shopping centers default on their debt ” – April 24th 2020.

2) Ray Dalio (Co-CIO, Bridgewater Associates) : Key points made in his 13,000 word essay
    - “Printing money to buy debt (called debt monetization) is vastly more politically palatable as a way of getting money and shifting wealth from those who have it to those who need it than imposing taxes, which leads taxed people to get angry.”
    - “The U.S., by having the U.S. dollar as the world’s reserve currency and having the world’s bank that produces that currency, and by having the power to put these needed dollars in the hands of Americans, can help Americans more effectively than other countries’ governments can help their own citizens. At the same time the U.S. risks losing this privileged position by creating too much money and debt.”
3) Scott Minerd (CIO Guggenheim Investments): “Break in uptrend signals new decline is S&P 500 to 2000 or lower”

PACE 360’S FUTURE OUTLOOK

“We yet again experienced a sideways week for the risk assets. However, the last week has not ended on a bearish note which is quite an achievement considering the news flow from Covid-19, corporate results and the economic data. We believe the markets are setting up a base or a launch pad for an eventual move higher. We foresee a risk on phase over the next five weeks which may see sizeable rallies in risk assets. We are particularly getting bullish on EM currencies from their current beaten down levels. We reiterate our long-term bullishness on gold and silver.”

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