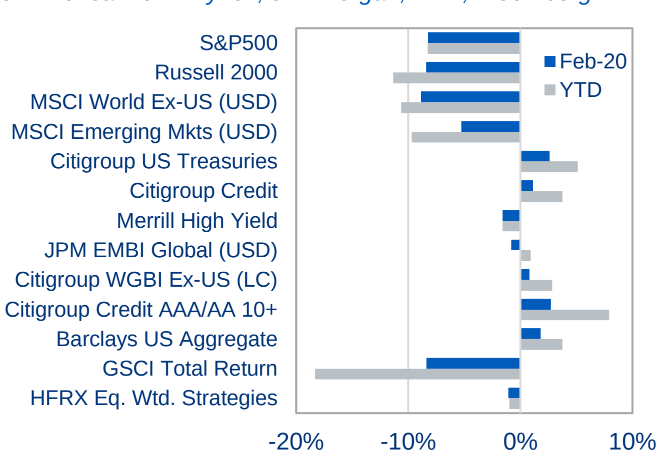
Global Market Review

Macro Summary

Coronavirus contagion added a layer of uncertainty to already fragile economies and markets. Even before the outbreak, markets faced risks from slowing global growth, trade tensions, a messy Brexit, richly valued global equity and bond markets, mounting global debt, and deteriorating credit quality. The prospect of contagion from China through output declines, broken supply chains, travel bans, falling consumer and business confidence, and declining demand for commodities sent a spasm through markets in February. Global equity and commodity prices plunged while yields on safe haven bonds fell to record lows.

Performance of Major Market Indices

Sources: S&P, MSCI, FTSE Russell, Barclays, Citigroup, Bank of America Merrill Lynch, J.P. Morgan, HFR, Bloomberg.



Coronavirus spreads fear and a flight to safety.

Channels of Contagion

The Coronavirus poses both a supply and a demand shock. China is the world's second largest economy, accounting for a high share of global industrial output (22%), GDP (17%), and trade (11%). Its pivotal role in complex global supply chains means that a shock in China is widely felt, especially in industries like computers, electronics, pharmaceuticals, and transport equipment that are heavily reliant on Chinese intermediate inputs. On the demand side, China represents a high share of global demand for key commodities, including aluminum (55%), copper (50%), nickel, zinc, lead, rubber (40-45%), and oil (12%), and accounts for 9% of global tourism. Coronavirus' confidence effects undercut consumer and business spending, as well as business and leisure travel, further depressing demand. The OECD estimates that, if the virus does not spread further and dissipates in a few months, global GDP growth will be 2.4% in 2020, down from a pre-virus estimate of 2.9%. Should the virus spread more widely and persist longer, global economic growth would fall to 1.4% in 2020, triggering recessions in Japan and the euro area among other countries.

The policy response to the crisis has been far reaching. Advanced economy central banks have indicated their readiness to ease further, while China and other emerging economies in Asia are planning fiscal measures to forestall a severe downturn. The ultimate efficacy of these measures remains an open question. For the moment, disinflationary forces from a demand shock appear to be dominant. However, there is a risk that much reduced supply could eventually turn inflationary, creating a stagflation reminiscent of the 1970s.

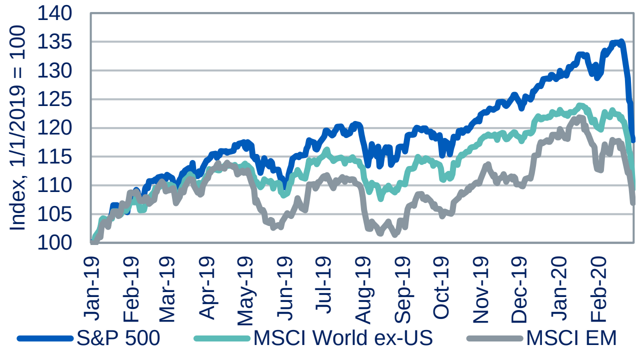
U.S. Stocks Plummet from Lofty Heights

The speed of the U.S. equity selloff is particularly striking. The correction in February is the most rapid on record. The U.S. equity market, which had been trading at all-time highs following its 31% gain in 2019, is down 13% from its high, and 8.2% for the month, returning to price levels last seen in October of 2019 (Exhibit on next page). In reaction to the spread of the virus, the VIX index of implied volatilities for U.S. equities, also known as the fear gauge, spiked.

The sell-off hit all sectors, market capitalizations, and styles. The energy sector was hardest hit, falling 15.2%. Financials and utilities tumbled 11.5% and 10.6%, respectively. Growth stocks fell less than value, with the Russell 3000 Growth slipping 6.8% against a 9.7% dip for its value counterpart.

Global Equities Plunge on Coronavirus Concerns

Source: Bloomberg.



Global Stocks Plummet

Global equity markets fared only marginally better than their U.S. counterparts did as the MSCI ACWI slid 8.1%. As in the U.S., shares in the energy sector fared the worst, reflecting the prospect of falling demand. Developed non-U.S. markets fell nearly 9% on fears that the shock from China would push their vulnerable economies into recession. Both European and Japanese bourses fell by over 9%. Italy, Europe's third largest economy, teetered on the edge of a recession as it suffered a major outbreak of the virus in its industrial heartland, while Japan saw the virus spread rapidly, disrupting output and closing schools.

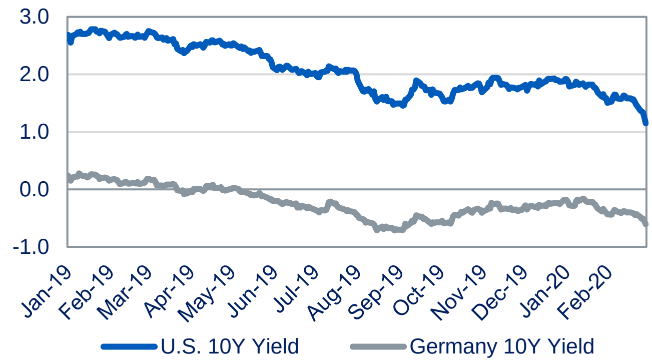
Emerging markets fared markedly better, with the MSCI emerging markets index losing 5.3% (Exhibit above). Manufacturing activity in China plunged as factories endured long and unexpected shutdowns and strict quarantine measures prevented nearly 300 million migrant workers from returning to their jobs. Nevertheless, the MSCI China Index posted a surprising gain of 1%. Among emerging markets, Latin American bourses were hardest hit, falling 12.1%, on the prospect of sharply declining demand from China for raw materials and other exports.

Investors Flock to Safe Haven Assets

Safe haven assets benefited from rising risk aversion. The yield on the 10-year U.S. Treasury hit an all-time low of 1.03% (Exhibit below). Real yields on 10-year TIPS also reached a new low of -28 basis points, and inflation expectations declined to 1.3%, reflecting fears that disinflationary forces will be unleashed by a significant downturn in activity. Long-dated U.S. Treasuries gained 6.8% in February and have been the best performing asset so far this year. In the credit markets, long-dated investment grade bonds also performed well, while high yield bonds suffered relatively muted declines. Outside of the U.S., other safe haven bond yields have also dropped, with the yield on the 10-year German bund falling to a low of -61 basis points (Exhibit below). At end-February, the stock of bonds priced to generate negative yields stood at $14 trillion, 23% of all bonds outstanding.

Yields Reach Record Lows

Source: Bloomberg.



Equity Hedge Funds Struggle

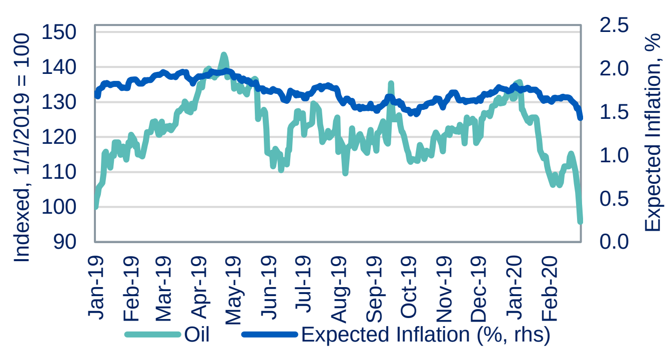
The HFRX Equal Weighted Strategies Index dipped 1.1% in February, driven by widespread weakness across most strategies. Equity long/short strategies struggled most, closing 3.8% lower. Relative value, which ended the month unchanged, was the only strategy not to post negative returns.

Commodity Markets Sell Off Feverishly

Commodity prices, and especially oil, were hard hit by the prospect of much reduced demand from China and a slowing global economy (Exhibit below). The S&P GSCI dropped 8.4% in February, dragged down by the 13.2% fall in crude oil.

Weak Demand Weighs on Commodities

Source: Bloomberg.



Performance of Major Market Indices through 02-29-2020

Sources: MSCI, FTSE, Barclays, Citigroup, Bank of America Merrill Lynch, J.P. Morgan, S&P GSCI, HFR, Bloomberg.

	1-Month	QTD	YTD	1-Year	3-Year	5-Year
S&P500	-8.2%	-8.3%	-8.3%	8.2%	9.9%	9.2%
Russell 2000	-8.4%	-11.4%	-11.4%	-4.9%	3.5%	5.1%
MSCI World Ex-US (USD)	-8.9%	-10.6%	-10.6%	-0.4%	3.9%	2.0%
MSCI Emerging Mkts (USD)	-5.3%	-9.7%	-9.7%	-1.9%	4.9%	2.7%
Citigroup US Treasuries	2.6%	5.1%	5.1%	12.0%	4.8%	3.2%
Citigroup Credit	1.1%	3.8%	3.8%	15.5%	6.6%	4.9%
Merrill High Yield	-1.6%	-1.6%	-1.6%	5.9%	4.7%	5.2%
JPM EMBI Global (USD)	-0.8%	0.9%	0.9%	9.9%	5.2%	5.7%
Citigroup WGBI Ex-US (LC)	0.8%	2.8%	2.8%	7.6%	3.5%	2.8%
Citigroup Credit AAA/AA 10+	2.7%	7.9%	7.9%	27.3%	11.0%	7.5%
Barclays US Aggregate	1.8%	3.8%	3.8%	11.7%	5.0%	3.6%
GSCI Total Return	-8.4%	-18.3%	-18.3%	-15.1%	-3.9%	-7.8%
HFRX Eq. Wtd. Strategies	-1.1%	-1.0%	-1.0%	2.9%	0.7%	0.8%