Mutual Limited

Morning Mutterings: Wednesday 14 October, 2020

Quote of the day…

"Why waste your money looking up your family tree? Just go into politics and your opponent will do it for you …" – Mark Twain

The short story "go big or go home…!"

- ***Overview –*** US Q3 reporting season underway last night with JPM and Citi teeing off. JPM reported provisions for credit losses of $611m, well shy of the $2.4bn consensus estimate. Revenue, investment banking fees, FICC sales & trading and equities all outpaced consensus. Citi's credit provisions amounted to $2.3bn vs $3.9bn consensus. Earnings and FICC sales & trading revenue also beat consensus. Fiscal stimulus talks in the US are stuck in neutral. Again, the sticking point remains the wad of stimulus needed to do the job – obviously the Dems think a bigger pile of cash is needed than that tabled by the Republicans. Members on the right have proposed some stop-gap measures, but this has been rejected with Trump promptly tweeting "*Go big or go home!!*" He really is a poet at heart. Nancy didn't hold back though, "*Tragically, the Trump proposal falls significantly short of what this pandemic and deep recession demand*". And the difference? It's around $400m, $2.2 trillion vs 1.8 trillion.

- ***Stocks*** – modest losses in all but the NASDAQ overnight with banks leading the charge south. Despite JPM and Citi beating consensus on the severity of provisioning (lower), the narrative turned decidedly sour, i.e. "*banks led losses in the S&P 500, with JPM and Citigroup sinking as investors worried that third-quarter results signalled just a pause in pain from soured loans*". The narrative also honed in on the fiscal package stalemate. It is widely viewed that more stimulus is needed to help propel the recovery…and realistically support frothy valuations. September saw a near 10% correction in US stocks on these concerns, yet markets have clawed all but a final few basis points of this correction back…still no fiscal package, and no improved recovery prospects. Another correction perhaps? Possible given we're in the final straight of the US Presidential election. Weak leads for the ASX 200 today.

"In the trenches…"

Source: www.hedgeye.com

	At a glance….	*Last*	*1D*	*30D*
EQUITIES	ASX 200	68,835	1.0%	5.1%
	DOW	28,680	-0.5%	2.5%
	S&P 500	3,512	-0.6%	3.8%
	NASDAQ	12,083	0.0%	7.1%
	STOXX	371	-0.5%	0.7%
CREDIT	AusBond FRN (bps)	45.5	-1.16	-4.81
	AusBond Fixed (bps)	92.5	-1.08	-2.19
	US Fin (OAS, bps)	101.7	-0.28	-5.91
	EU Fin (OAS, bps)	62.5	-0.90	-5.67
BONDS	ACGB (10Y, %)	0.848	0.00	-0.02
	ACGB (3Y, %)	0.138	0.00	-0.10
	UST (10Y, %)	0.729	-0.04	0.06
	UST (2Y, %)	0.139	-0.01	0.00
FX & CMDTY	Oil (Brent, $/bbl)	42.43	1.7%	7.1%
	Gold ($/oz)	1,892	-1.6%	-3.3%
	AUDUSD	0.716	-0.7%	-1.8%
	AUDEUR	0.610	-0.1%	-0.8%

Source: Bloomberg, Mutual Limited

- ***Offshore Credit*** – modestly active session in offshore primary with a handful of deals across US and EU IG markets. Deals were well supported. Secondary spreads are a touch tighter, but at the index level there isn't much in it (↓1 bp). Synthetics followed the tone in stocks, closing wider…probably wider than I would have expected given the modest moves in stocks. CDX is ↑1.9 bps wider, while MAIN is ↑1.2 bps wider. Offshore bank CDS (Snr Fin) is ↑2 bps.

- ***Local Credit*** – continued strong bid tone across local markets with major bank senior paper grinding tighter – 3Y at +31 bps (↓1 bp) and the Jan-25's are at +41 bps (↓1.5 bps). Tier 2 is on a tear, all major lines tighter. ANZ 31-26 at +175 bps (↓2 bps), NAB 31-26 at +184 bps (↓1 bps), CBA 30-25 at +171 bps (↓1 bps), while the 29-24 suite of lines is at +164 bps (↓3 bps). We have been positioned for this move tighter for several weeks now.

- ***Bonds*** – the modest risk off tone saw US treasuries bull flatten ↓3 bps, while in local bonds, very little action over the past few sessions.

- ***Ahead*** – Q3 results from Wells Fargo, BofA and GS are due out tonight; MS earnings are scheduled for Thursday.

The long story…

Credit – "staying strong…"

- US primary saw just \$3.4bn priced across two deals. Market projections are calling for \$15bn in issuance this week, so off to an ok start. Spread compression from launch to final pricing was modest vs recent averages, ↓15 – 17 bps. In Europe, a little more-vigorous on the primary front with €8.2bn priced. Deals were 4x oversubscribed, which saw spread compression of around ↓23 bps.
- AU primary is seeing dribs and drabs, mainly in ABS / RMBS and the odd offshore bank, the latest being Mizuho. Still a long absence since the last ADI deal was done…oh, wait…I forgot about Australian Military Bank (Baa1) who are sniffing around for a 10-NC-5 tier 2 (Baa3). Given the yield outlook and lack of paper elsewhere, I'd suggest the deal would be well supported…having said that, it's a tiny bank with just \$1.2bn of loans, \$1.3bn of deposits and members equity of just shy of \$100m. At best, they'd squeeze out a \$20m deal.
- ***Prevailing theme – tactically equity volatility has eased off on the apparent stabilising US political outlook, which is generally supportive of spreads. Prevailing fiscal and monetary policy stances are supportive of the recovery prospects, which exerts a tightening bias on spreads. Spread practicalities are however that local spreads are generally tight, so scope for meaningful tightening is limited – especially in major bank senior paper. Tier 2 is offering more scope however, which is what we've seen. Risk appetite will likely firm up further once we get through the US election and the result pans out as markets currently expect. Spreads will also benefit from more accommodative monetary policies from the RBA. Longer term, over the next 6 months or so, we're focused on when the Victorian economy is to re-open and what happens with mortgage deferrals (i.e. bank asset quality impact) as key fundamental events.***

Stocks – "needs a leg up to take the next step"

- US markets have clawed back all but a few basis points of the September mini-correction, which saw the S&P 500 drop ↓9.6%. Despite last night's modest pull back, the S&P 500 is near post pandemic highs. Much of the bounce off September lows was fuelled by expectations of a fiscal boost, and some might say the firming political outlook – i.e. Biden to win comfortably based on polls and odds. I'm less assured on the latter. Having done a lot of work on the US electoral process over the past week, Trump cannot be discounted. Also, even if Biden wins, there is a very high probability that Trump will contest the result. This will likely see a spike in volatility and therefore put downside tactical pressure on liquid risk assets.
- ASX 200 broke through its 5800 – 6150 six-month trading range yesterday, closing at 6196. Now, does it have legs to go further, or is it just setting a slightly higher upper boundary and will range trade from here? The other question, from an investment strategy perspective is would I add risk at these levels, or take some off the table….and of course there is the option of letting it ride. First things first, what has driven the rally – see above to some degree, but also clarity around the domestic budget and expectations of further monetary policy accommodation. Given the potential for volatility over the coming weeks stemming from the US election, I'd be hesitant to chase risk down the rabbit hole.
- ***Prevailing theme: despite breaking through to the topside of recent ASX 200 5800 – 6150 trading ranges (closed at 6196), we remain cautious. Domestic fiscal stimulus and accommodative monetary policy will continue to provide supporting pillars, however there is a risk markets have mispriced the US election outcome, which could see a spike in volatility. Downside should be limited, but at the same time we struggle to see any tangible upside catalysts, at least none with high confidence levels. By traditional measures, stocks are still expensive compared to fundamentals and the uncertain macro outlook. It's all politics for now…***

Bonds & Data – "range bound…"

- Not a lot to add, bonds still pricing an uncertain outlook. The US election result will have some ramifications for bonds depending on who wins. I'll be putting something out over the next day looking at the various potential election outcomes and what each likely means for markets, including bonds.

- *Prevailing theme: still lower for longer, but risk to trending higher (yields) exists if the fiscal stimulus and monetary accommodation is deemed to be highly stimulatory, then rates will rise on recovery prospects. It will then be subject to RBA meddling (buying) to maintain as much accommodation as deemed necessary – which will be quite a lot.*