M Mutual Limited

Morning Mutterings: Thursday 15 October, 2020

Quote of the day…

"When will I learn? The answers to life's problems aren't at the bottom of a bottle. They're on TV! …" – ***Homer J Simpson***

The short story "lazy narratives…"

- ***Overview –*** I thought markets had already reached the realisation that a new US fiscal stimulus package wasn't going happen before the election, but again it's been thrown up in the narrative as the reason for last night's modest risk-off tone. This time it was Treasury Secretary Mnuchin who poured the cold water on expectations – nevertheless, both sides are still talking to each other, so hope springs eternal, I guess. US Q3 reporting season continued, with a mixed set of results from Wells Fargo (very poor), Bank of America (MISS vs consensus), and Goldman Sachs (BEAT vs consensus). E-mini's are down ↓0.6% - 1.0% across US indices, while ASX 200 futures are suggesting a moderate down day, ↓0.25%
- ***Stocks*** – mixed across European stock markets, some up, some down, modest moves. In US markets, again the narrative lacks imagination and has pointed to both mixed bank earnings and the dawning realisation that a fiscal package is not imminent. Combined the two narratives sucked some of the jam out of the market's donut. A touch over half of the S&P 500 closed down on the day. One bright spot was energy shares, which were boosted by the rally in oil (↑1.9%). The ASX 200 was off its food a touch yesterday, down on minimal local news, instead following offshore leads directionally.
- ***Offshore Credit*** – mixed again in primary, with just a couple of deals in US IG for $1.6bn, while in EU IG we saw five borrowers for €5.4bn. One of these included Japanese beverage group, Asahi, who were tapping markets to help fund its purchase of Caaarlton & United Breweries. US deal metrics were ok, new issue concession of +3 bps and books were covered by 1.6x – well down on recent levels, but was only two deals, and spreads compressed 12 – 15 bps post launch. In EU IG, books were 4.1x oversubscribed with spread compression of a robust 34 bps on average. In CDS, again mirroring tone in stocks with CDX ↑1.3 bps wider and MAIN ↑1.8 bps wider.

"Rose-coloured glasses…"

Source: www.hedgeye.com

	At a glance….	*Last*	*1D*	*30D*
EQUITIES	ASX 200	68,652	-0.3%	4.8%
	DOW	28,593	-0.3%	2.1%
	S&P 500	3,499	-0.4%	3.4%
	NASDAQ	12,035	-0.4%	6.7%
	STOXX	371	-0.1%	0.6%
CREDIT	AusBond FRN (bps)	44.8	-0.71	-5.52
	AusBond Fixed (bps)	92.3	-0.26	-2.45
	US Fin (OAS, bps)	101.8	-0.18	-5.80
	EU Fin (OAS, bps)	62.0	-0.53	-6.20
BONDS	ACGB (10Y, %)	0.838	-0.01	-0.03
	ACGB (3Y, %)	0.142	0.00	-0.10
	UST (10Y, %)	0.722	0.00	0.05
	UST (2Y, %)	0.139	0.00	0.00
FX & CMDTY	Oil (Brent, $/bbl)	43.38	2.2%	9.5%
	Gold ($/oz)	1,904	0.7%	-2.7%
	AUDUSD	0.717	0.1%	-1.7%
	AUDEUR	0.610	0.0%	-0.7%

Source: Bloomberg, Mutual Limited

- ***Local Credit*** – holy spread tightening Batman. Once again, a scramble for risk, driven by real money buyers and street trading desks looking to build inventory. Also reflecting the buoyant tone, the new Mizuho 3-year FRN printed ↓12 bps tight to initial guidance. On the day, major bank senior paper reached new tights with 3-year at +29 bp (↓2 bps), while the Jan-25's crunched in ↓3 bps to close at +38.5 bps. We're not in Kansas anymore Toto!
- ***Bonds*** – little movement in bonds overnight, and local bonds are relatively stable also. Guvna Lowe speaks at the Citi Investor Conference today, topic is "*The Recovery from a Very Uneven Recession*". At 9am.
- ***Ahead*** – September labour data is out today. Consensus is expecting ↓40K (vs ↑111K in August) and unemployment rate of 7.0% vs 6.8% last month. Beyond this, we have clean air for a few days.

The long story…

Credit – "major bank senior spreads hitting new tights…"

- In local markets yesterday it was all about primary and the main event was the Mizuho (Sydney Branch) three-year floater, which was met with strong demand. The A/A2 rated bank launched at +65 bps, which attracted just short of $1.5bn of bids. In the end the del was scaled to $700m and priced at +53 bps, yep ↓12 bps tighter. Major bank 3Y senior paper, rated AA-/Aa2 (+2 notches to Mizuho), is trading around +31 bps, so the new Mizuho offers +11.5 bps per notch differential, which is around average (historically).
- Given the tightening witnessed in local spreads, questions are now being ask, will spreads hit pre-GFC tights? Short answer, yes, I think they will. It's just a question of when. For context, average spreads for AU IG (fixed) reached lows of +25 bps – 35 bps in 2007. Today the same universe (or index) is +92 bps (being the AusBond Credit Fixed Index, formally the UBS Credit Index). In the FRN space, at an average spread of +45 bps, we're much closer to these pre-GFC levels.
- Bank of Queensland (BBB+/A3) released FY'20 results yesterday. Total operating income was flat at $1.1bn whilst net profit fell ↓61% YoY to $115m. NIM dropped ↓2bps to 1.91%. BOQ has booked $147m of loan impairments (or 62 bps of GLA – higher than system average at this stage) with $123m COVID 19 related. Total provisions held amounted to $369m with $133m due to COVID. Dividends were cut their ↓by 81.5%. The CET1 ratio increased by ↑75 bps to 9.78%. In terms of loan deferrals, they've dropped by ↓18.8% to $6.2bn since the April peak, housing still has 12% in deferral whilst SME has 16%. Proportionately higher than peer average. BOQ has $2.6bn available under the TFF, currently they've drawn $0.8bn giving them capacity for $1.8bn. Senior maturities for FY'21 amount to $1.4bn so chance of any issuance is extremely low. Guidance - for FY'21 management believe the Australian economy is well placed after fiscal stimulus, expects to broadly deliver neutral jaws due to growth in lending, margin management to within 2-4 bps decline, and cost growth of around 2%.
- ***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…maybe not given recent moves. 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. Fundamentals will remain pressured, but we expect technicals to over-power any serious risks here for the immediate term. What happens with mortgage deferrals (i.e. bank asset quality impact) remains a key fundamental outcome for Australian credit markets.***

Stocks – "setting new upper trading boundaries"

- Again, its all about fiscal stimulus and expectations for such. If we were to wake up tomorrow and the word was no new fiscal stimulus to come down the pipe, then we'd see a meaningful correction. But that won't happen, something is coming, something will come, its just a question of when – pre or post-election. The US Presidential election is the other key variable for now. A Biden/Democrat victory is the base case scenario for now, given polls etc, but a Trump re-election can't be discounted either.
- The ASX 200 lost ground yesterday, albeit modestly following weaker leads from offshore. Despite the modest pull back, levels are still above the previously quoted three-month trading ranges. Around a third of the index closed lower on the day and seven out of eleven sectors closed in the red. Healthcare, IT, Staples and Discretionary sectors were the only sectors to close higher, ↑0.7% - 1.3%, while at the other end, Energy, Telcos, Financials and Industrials all closed lower, ↓0.9% - 1.0%. Volatility decline, dropping 72 bps to 20.9% (post pandemic trading range of 18.0% - 25.0%).
- ***Prevailing theme: despite breaking through to the topside of recent ASX 200 5800 – 6150 trading ranges (closed yesterday at 6179), we remain cautious. I'm leaving trading ranges unchanged as I expect the ASX 200 is just a tourist at these levels with the likely election induced volatility to play on sentiment over the near term. Domestic fiscal stimulus and accommodative monetary policy will continue to provide supporting pillars. 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 – "no material change to themes…"

- US Fed-Speak…Fed Vice Chair, Richard Clarida has stated the US economy has "*a long way to go*" before economic output returns to pre-pandemic levels, at least a year or more, and "*even longer*" for employment. He was again singing from the Fed's hymn book, stating additional support from monetary — and probably fiscal — policy will be needed. Richmond Fed chief, Thomas Barkin, has also piped up, warning that a rebound in US infections to about 50,000 a day has added uncertainty to the outlook and may discourage businesses from hiring or investing. Keep in mind also, European infection rates have spiked to 100,000 a day.
- Australian consumer confidence data out yesterday, coming in at a strong 11.9% improvement to 105.0 vs 93.8 last month, levels not seen since mid-2018. This represents the most aggressive rebound in the history of the data series, likely reflecting extensive government support provided to households. According to NAB "*such a rapid turn in confidence may suggest a sharp bounce back in activity is in store for Q4, which would be further assisted if restrictions were eased further in Victoria*". NAB further noted "*the widespread lift in confidence is likely partly due to last week's Federal Budget (there was a special question where a net positive balance of 9.5% said the Budget would improve their finances), as well as greater optimism as states (bar Victoria) continue to re-open and start to relax interstate borders*".
- Sticking with local data, kind of…the IMF released its latest global macro growth forecasts. The IMF is forecast Australian GDP will shrink ↓4.2% in 2020, but bounce back ↑3.0% through 2021. This is a marked moderation on forecasts published in April where they were calling for a contraction of ↓6.7% for 2020 and expansion of ↑6.1% in 2021. Prevailing consensus growth expectations are for a ↓3.9% contraction this calendar year and ↑2.8% expansion through 2021. For the sake of completeness, the IMF is forecasting the global economy to contract ↓4.4% in 2021 and grow ↑5.2% through 2021.
- ***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.***