Mutual Limited

Morning Mutterings: Friday 16 October, 2020

Quote of the day…

"If you cannot prove a man wrong, don't panic. You can always call him names…" – Oscar Wilde

The short story "surf's up, dude…!"

- ***Overview –*** risk off session offshore in general, especially so in European markets as a surging COVID second-wave and talk of re-locking down large swaths of the continent is understandably reigniting macro concerns. In the US, seems the eternal market optimists just won't let go of their pre-election fiscal stimulus hopes and dreams, again that's what the narrative is spruiking. I guess while Pelosi and Mnuchin are still talking, there remains a faint glimmer of hope and that's enough in these crazy times. Trump also stoking the furnace, stating he'd go over the Republican's $1.8 trillion package – he has an election to win of course. More reporting season, this time Morgan Stanley surprised on the upside, which gave bank stocks in general a tickle, while an unexpected spike in US jobless claims added to the level of uncertainty and concern.

- ***Stocks*** – European stocks were smashed, down over ↓2.0% as a second wave of COVID infections spreads across the continent, and cities re-lockdown. US markets opened on the weak side, with futures down ↓1.0% when I hit the sack around 11pm our time. Physical's went as low as down ↓1.4% in early trading, hit also by data signalling a stall in post-pandemic job's creation. Despite these headwinds, stocks clawed their way back from the intra-day abyss, back to almost unchanged, fuelled by bank earnings and lingering optimism that a new fiscal support package might be squeezed out before the election in just under three weeks. The ASX 200 has remained relative resilient, keeping its nose above the high end of recent trading ranges, but will open with some downward pressure this morning.

- ***Offshore Credit*** – a sleepy day for US IG, just one deal announced. Again, EU IG a little more active, with €5bn priced. Deal metrics remain constructive, with books 3.5x oversubscribed and spreads compressing ↓11 bps from launch to final pricing. Spreads in secondary did little, very marginally tighter in EU IG, the opposite in US IG. In CDS, MAIN smacked around the chops, ↑2 bps, while CDX was half a basis point wider.

"Tattoo…"

Source: www.hedgeye.com

	At a glance….	*Last*	*1D*	*30D*
EQUITIES	ASX 200 (Acc)	68,998	0.5%	4.3%
	DOW	28,494	-0.1%	1.6%
	S&P 500	3,483	-0.2%	2.9%
	NASDAQ	11,899	-0.7%	5.8%
	STOXX	363	-2.1%	-2.7%
CREDIT	AusBond FRN (bps)	44.8	0.05	-6.10
	AusBond Fixed (bps)	91.7	-0.62	-3.58
	US Fin (OAS, bps)	101.7	-0.28	-4.55
	EU Fin (OAS, bps)	61.6	-0.38	-7.68
BONDS	ACGB (10Y, %)	0.766	-0.07	-0.10
	ACGB (3Y, %)	0.138	0.00	-0.09
	UST (10Y, %)	0.732	0.01	0.04
	UST (2Y, %)	0.139	0.00	0.00
FX & CMDTY	Oil (Brent, $/bbl)	43.17	-0.3%	2.3%
	Gold ($/oz)	1,908	0.3%	-2.6%
	AUDUSD	0.709	-1.0%	-2.9%
	AUDEUR	0.606	-0.7%	-2.0%

Source: Bloomberg, Mutual Limited

- ***Local Credit*** – from the traders "*RBA Governor Lowe seemingly rubber stamped a micro cut in November whilst also raising expectations that we'll see some form of QE enacted in the near term. Spread product sharply tighter with moves amplified by the paucity of inventory available on secondary trading books*". Major bank senior and tier 2 is unchanged to a basis point tighter. Expect a pause in senior here, while tier 2 might have some legs.

- ***Bonds*** – crunchy, crunchy, crunchy, go yields, ACGB's fell yesterday with the good Guvna (Lowe) sending strong signals that they'll be adding monetary fuel to the market's fire at next month's meeting. ACGB 10-year yields plunged as much as ↓8 bps intra-day, but ended down a touch under ↓7 bps at 0.766%, new six-month lows. Three-years did little on the day. Despite the risk-off tone in offshore markets, US treasuries did little on the day, yields a smidge higher if anything.

The long story…

Credit – "same, same…"

- Not a lot here, for offshore at least. Spreads grinding a tad tighter with primary moderating. Also, nothing really to add from comments already made for local credit, although after a solid few session in major bank spreads, I suspect we'll consolidate at current levels. Tier 2 has some scope to tighten further.

- ***Prevailing theme – spreads are tight, especially in FRN's, less so in fixed. 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 in recent sessions. 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 – "clinging to fiscal unicorns"

- Talking heads…"*what we see the market doing today (last night) is reflecting what we think is still a lot of uncertainty*,"…"*so we do think it's appropriate for the market to be consolidating some here*"…valid comments ahead of the US election. While Biden is leading in the national polls, the state level polls – which are more important for the presidential race – are less decisive and it's a close race. In the national polls its 51.7 vs 42.3 in Biden's favour, a lead of +9.4. Across the key battleground states, Biden's average lead is +4.9 (49.4 vs 44.5), which is arguably within the margin of error.

- On the fiscal stimulus front, Bloomberg is reporting that Trump is calling for a bigger stimulus package than the $1.8 trillion his administration has proposed and is blaming Pelosi for delaying a deal. He has also dismissed talk that the Republicans are the stick in the mud "*We're not holding it up, she's holding it up*"…and true to form for Trump, he had to add that Pelosi has "*a lot of mental health problems.*"

- ***Prevailing theme: the ASX 200 has now spent three-days above the top end of its previously well-entrenched 5800 – 6150 six-month trading range. It's tempting to adjust the top end of this band to reflect higher levels, but again I still think we're a tourist at these levels, here for a good time, not a long time. Nevertheless, I suspect we'll stay in a 6000 – 6300 range for the near term, with the US election and offshore market reactions key catalysts for change. The growing European second-wave COVID situation remains a headwind. Domestic fiscal stimulus and accommodative monetary policy will continue to provide supporting pillars, but offshore drivers will grow in influence, especially the US election result and market reaction. Having said that, 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…"

- Guvna Lowe spoked at Citi's Investor Conference yesterday. His speech was titled "*The Recovery From a Very Uneven Recession*", copy *here*. Fair to say what he had to say moved markets. He commenced his speech at 9:00am, by 9:01am ACGB yields starting falling and by the end of his 45-minute speech (incl Q&A) and the 10's were ↓8 bps lower at 0.76%, levels not seen since April. Post the speech yields stabilised, edged up a touch, then labour data hit the screens and they legged it south again. So, what did he say…read attached link for specifics, but for mine this was the key outtake "*Is there benefit of us buying more longer-term bonds and what benefit would that have? If we buy bonds in the five to 10-year range, will that create more jobs? That's what we are discussing at our meetings.*"

- Market commentators interpreted the speech and Q&A as a sign rates will be cut further and additional policy measures will be rolled out…i.e. outright QE in the 5-10 year space. In this regard, he noted the bank's balance sheet has increased considerably, from a 3-year average of ~$170bn to $300bn. Sizeable in local terms, but minor in a global context. Another outtake, which has consequences for bank issuance in the credit space, Guvna Lowe ruled out a further expansion of the TFF at this time. Either way, a range of street market watchers adjusted their expectations for the November meeting, lower cost of debt for all (unless you've fixed your rate of course).

- Speaking of jobs, Australian labour data out yesterday. Employment fell 29.5K in September, shy of consensus median, which was for a fall of 40k. Victoria's second lockdown was a clear and still very present drag, offsetting the modest recovery experienced in other states. The unemployment rate inched up a smidge, from 6.8% to 6.9%, but still short of consensus at 7.0%. Again, a wide gap between the free (everyone but the Vic's) and the incarcerated (the Vic's). The overall participation rate was unchanged at 64.8%, while hours worked is around ↓5.1% below pre-pandemic levels (March). From NAB "*today's data continues to play to the view of little spill over from Victoria's lockdown to the rest of Australia, with employment and hours worked increasing outside of Victoria*".
- ***Prevailing theme: RBA Guvna Lowe asserted again in his speech yesterday that cash rates won't increase for at least three-years. Rates and yields will stay lower for longer, simple. Theoretically there is a risk yields will trend higher if the fiscal stimulus and monetary accommodation is deemed to be highly stimulatory, i.e. rates to rise on recovery prospects. Somewhat flippantly, that's old school thinking. The more debt we raise globally, both public and private, the lower the cost of debt, which goes against traditional thinking. Why, because central banks are buying it, and pumping liquidity into the system that needs to be parked somewhere. If rates and yields normalise, given the level of debt outstanding, the world is going to hell.***