

Working through the phases

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STATE STREET

The Four Phases of the crisis

Working through them

1. Liquidity

- Scramble for dollars
- Selling of all assets (both high beta and safe-havens) to raise cash

2. Caution

- Traditional risk-off market
- High levels of uncertainty, safe havens outperform

3. Repair

- Uncertainty begins to clear
- Return of idiosyncratic risk taking

4. Recovery

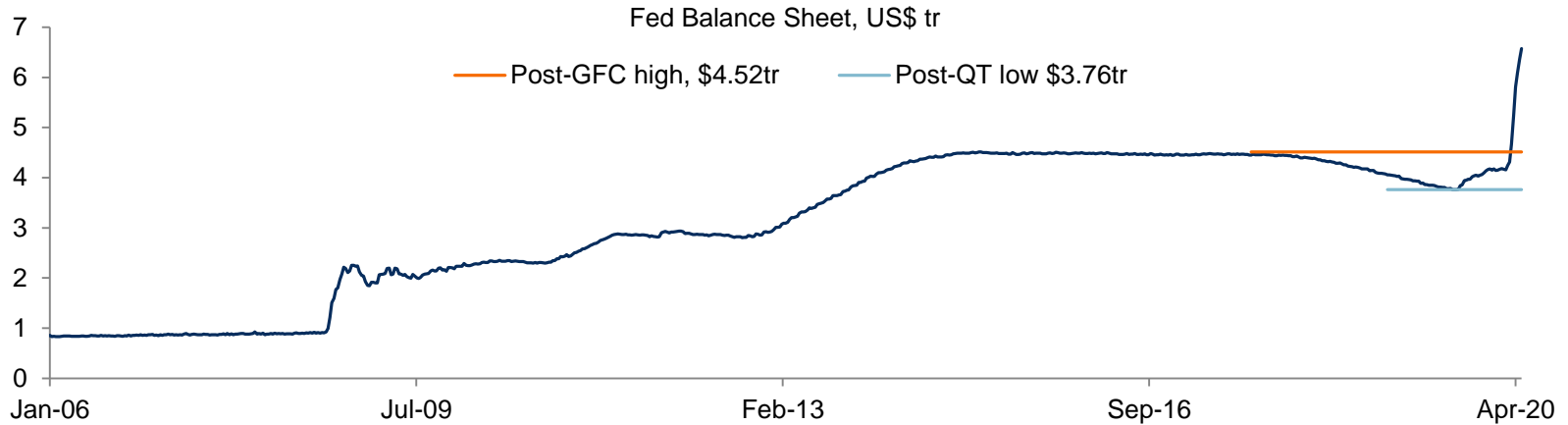
- Return to normality
- Widespread gains in pro-risk assets

² Source: State Street Global Markets, Bloomberg; data as of 4/24/20

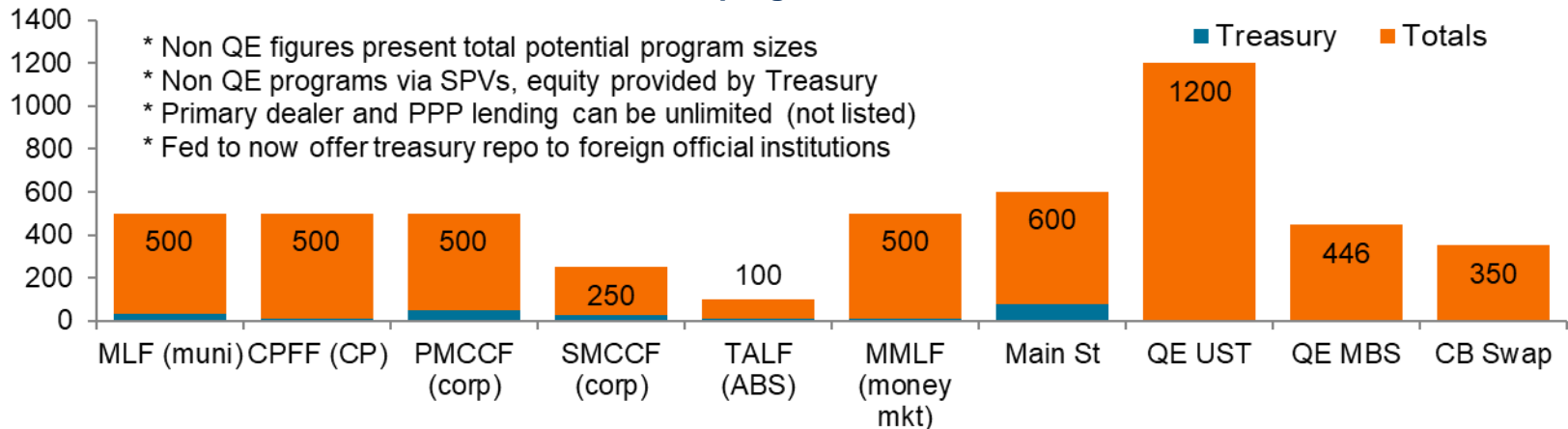
The Fed Bazooka

Balance sheet likely to reach \$10tr

Balance sheet rising sharply



And a lot more to come – programs announced so far, US\$ bn

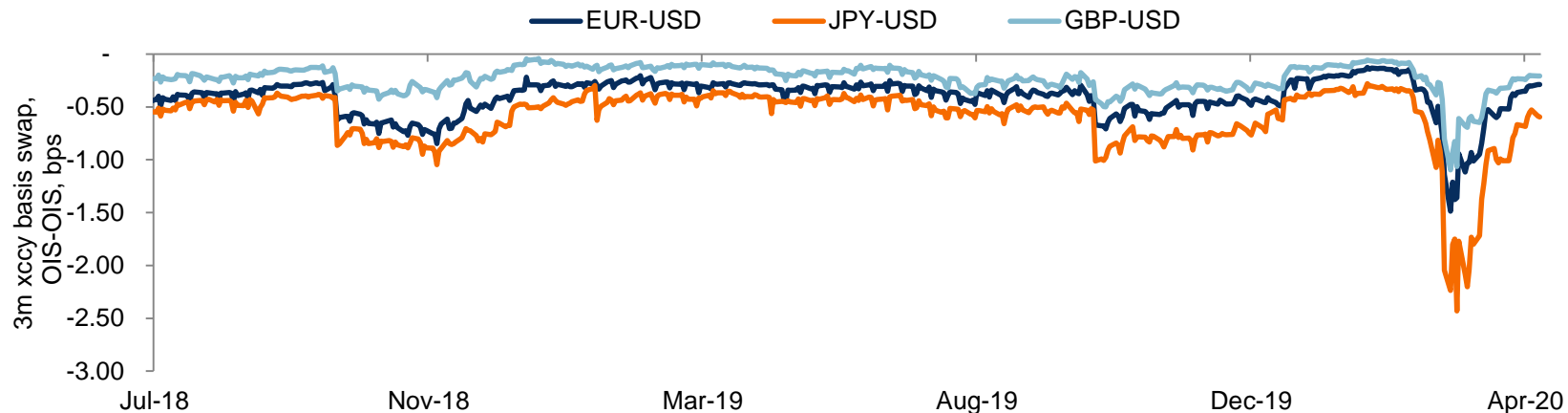


3 Source: State Street Global Markets, Federal Reserve, Bloomberg; data as of 4/24/20

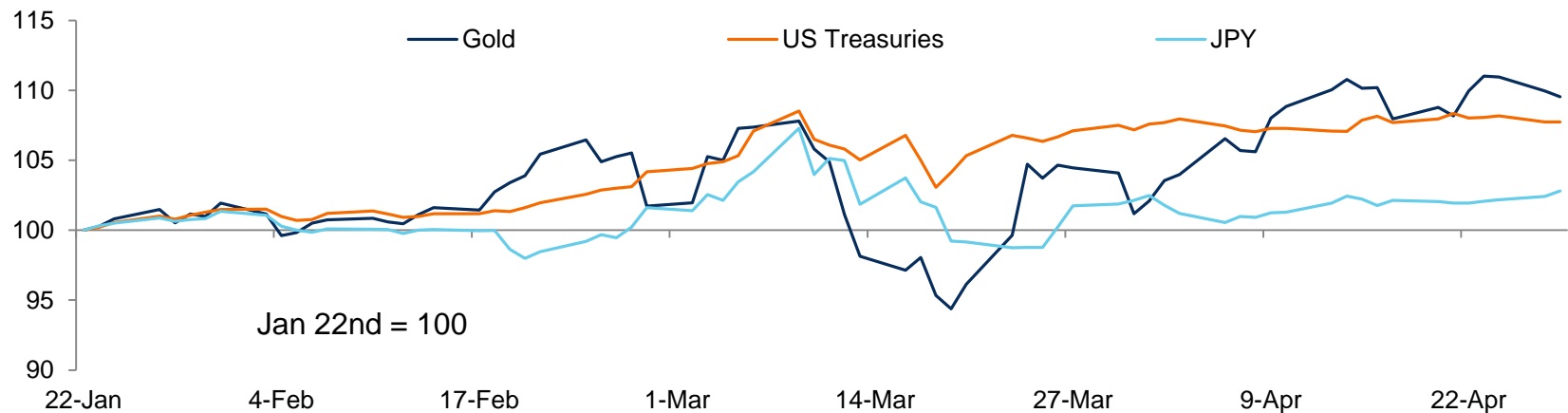
We have moved out of the liquidity phase

The scramble for dollar's has passed

Dollar funding pressures have eased



Safe havens are performing again

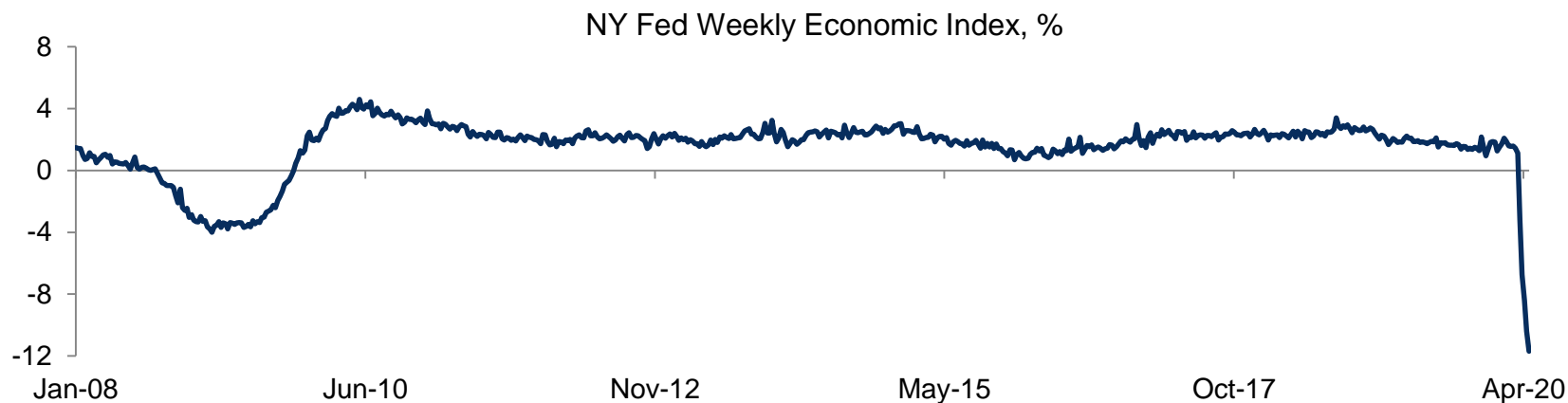


4 Source: State Street Global Markets, Bloomberg; data as of 4/28/20

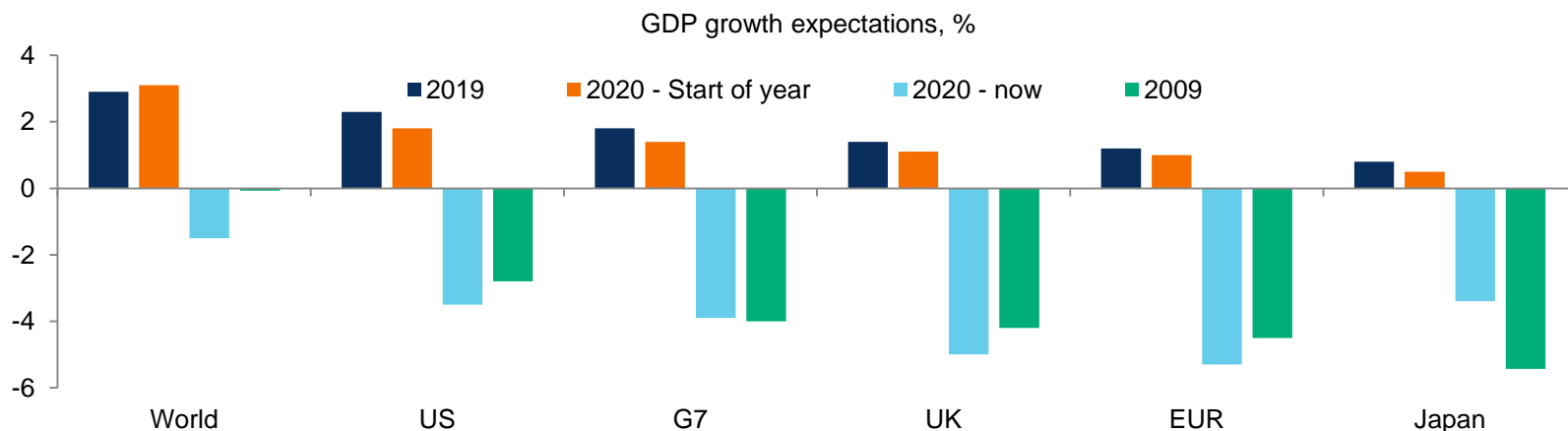
A very different world

Unprecedented stop in activity

The sharpest plummet we have ever seen



Still not pessimistic enough?

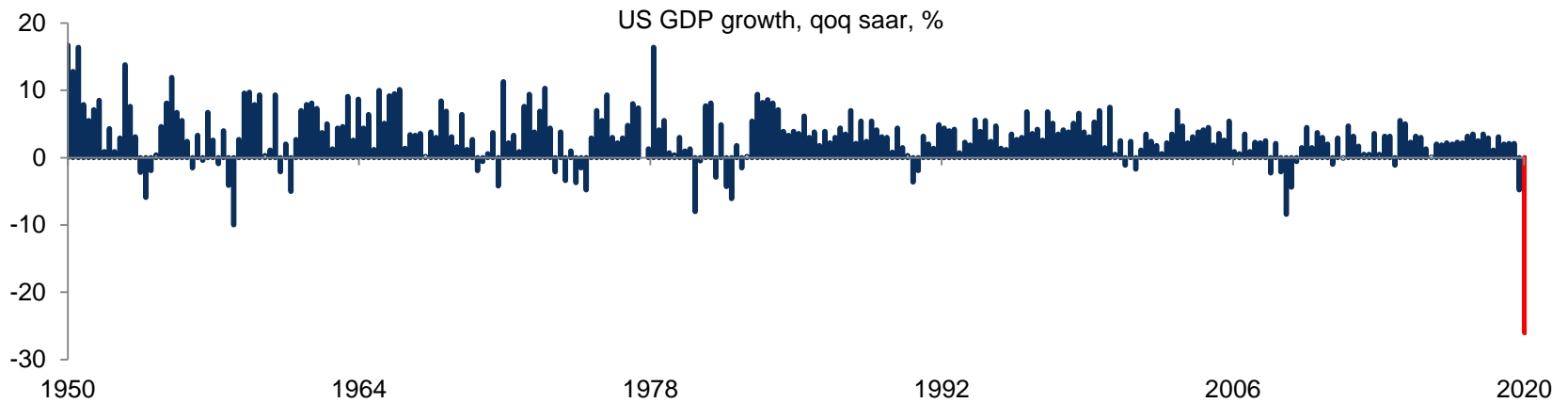


5 Source: State Street Global Markets, Bloomberg; data as of 4/24/20

Reality check

We have never seen anything like this

Off the charts



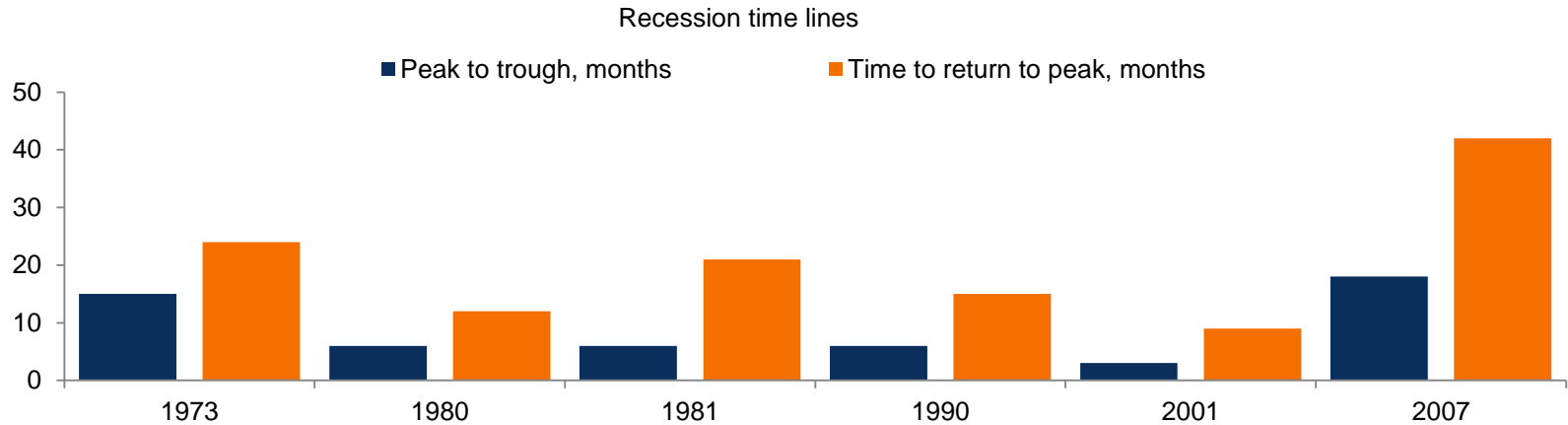
A lot of economic suffering



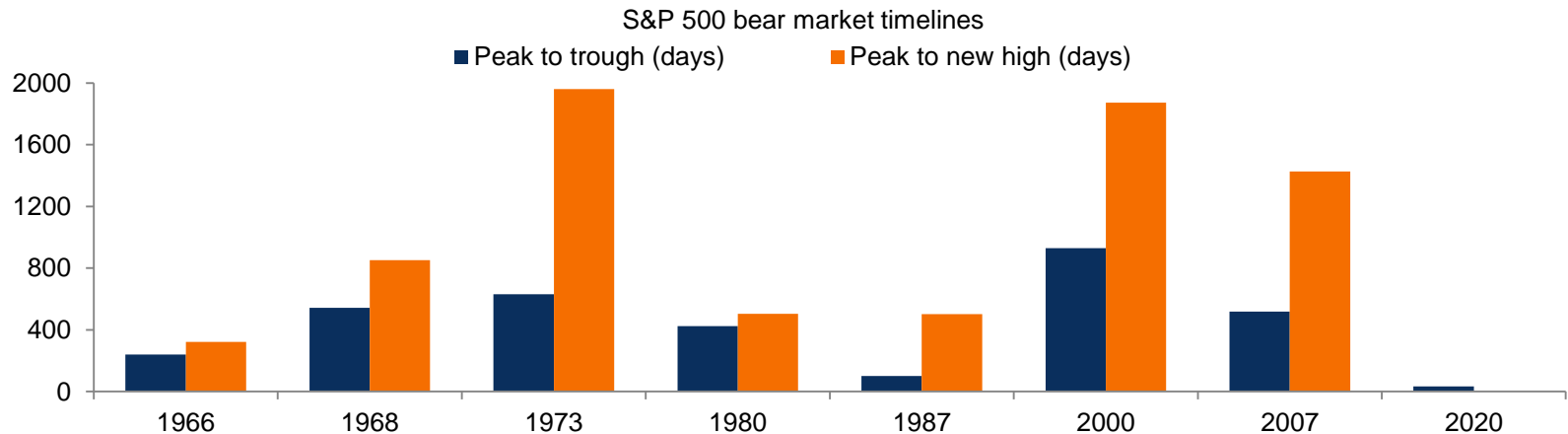
Lessons from history

V-shaped recoveries are rare

Recoveries tend to be drawn out



And so do market recoveries

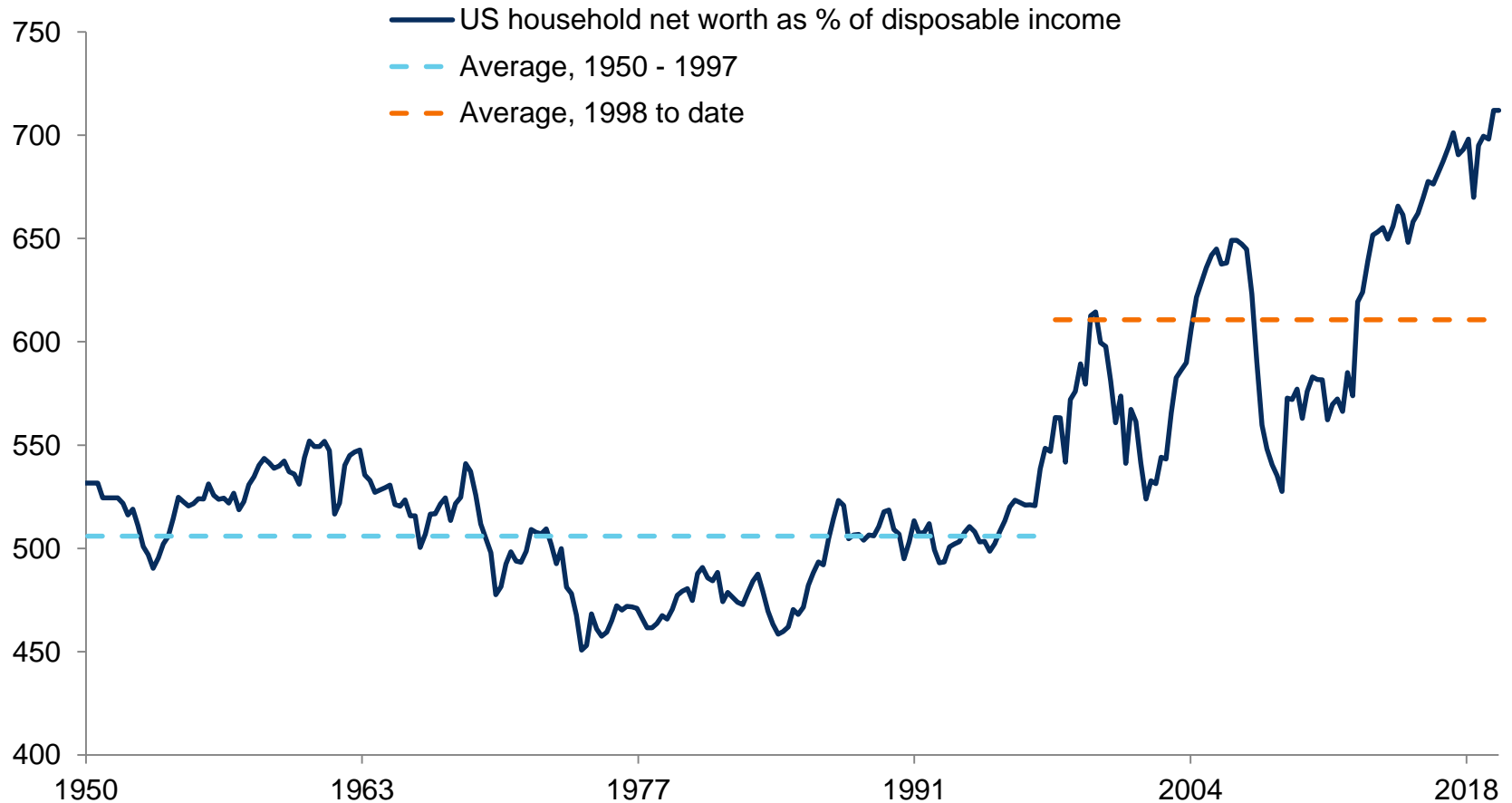


7 Source: State Street Global Markets, Bloomberg; data as of 4/29/20

House of cards

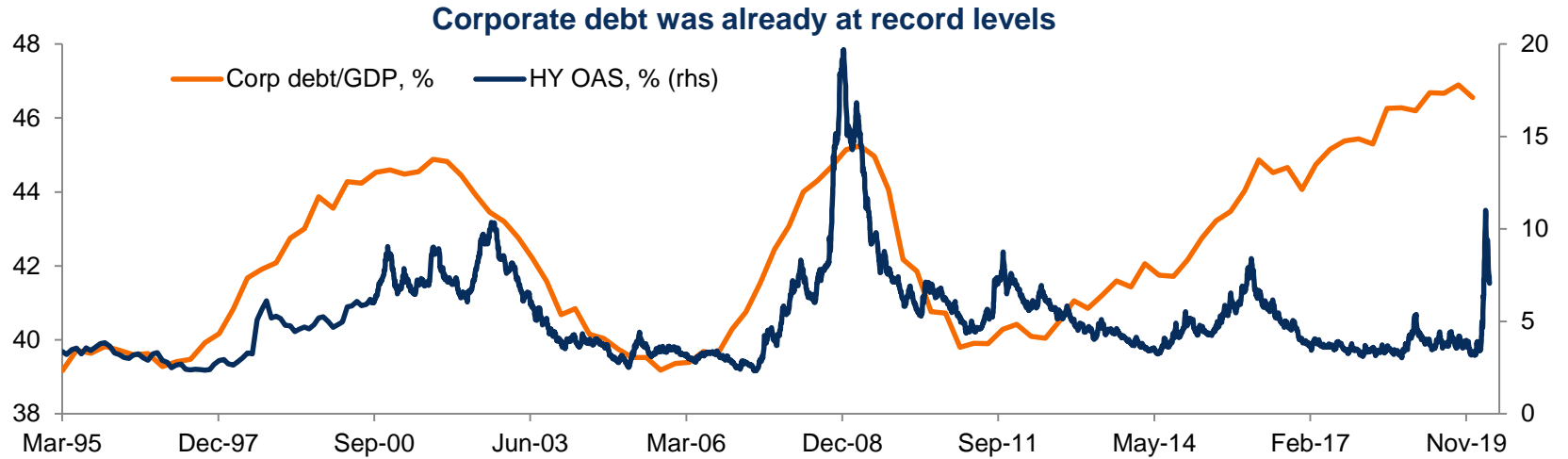
Loose policy had already made the system fragile

Mortgaging the future

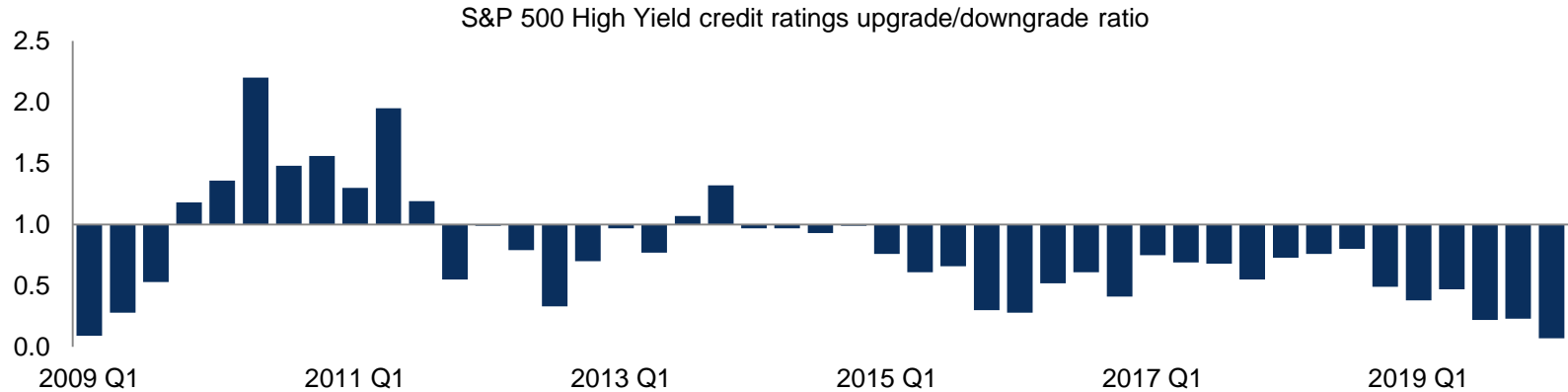


Vulnerabilities were already there - debt

Growth was built increasingly on loose policy and debt



And downgrades were already at 10-yr highs

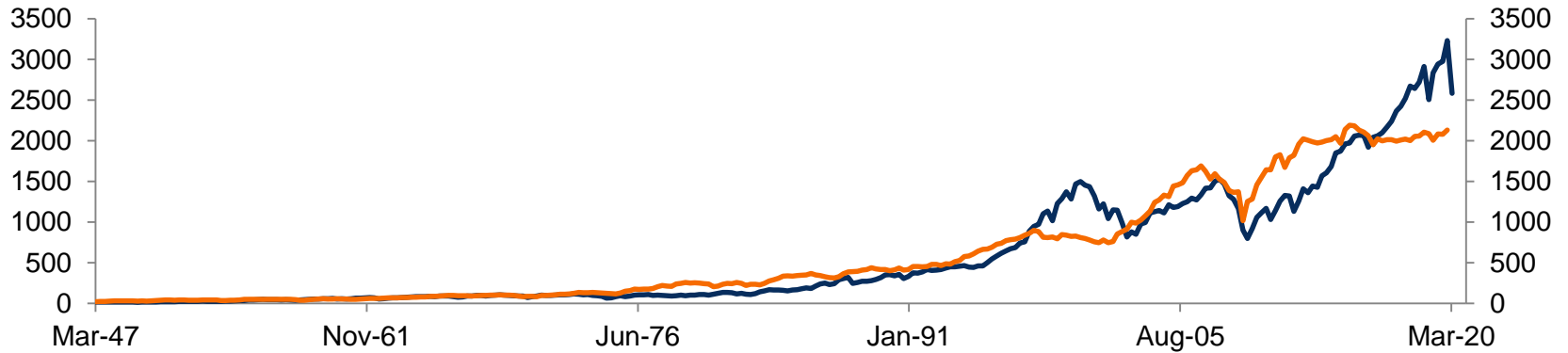


Vulnerabilities were already there - equities

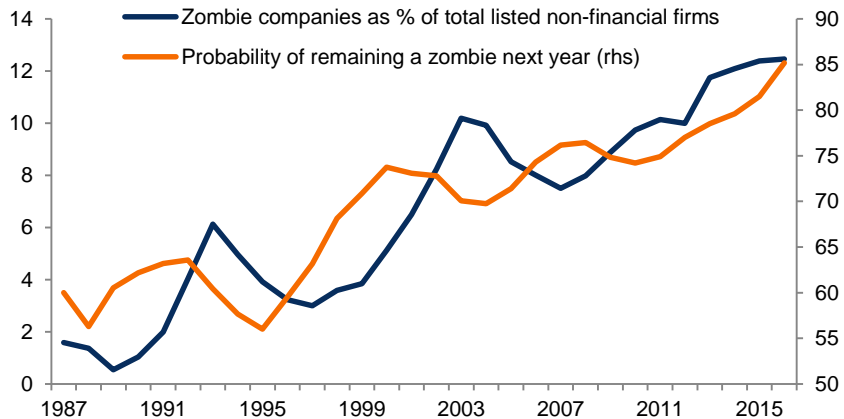
Growth was built increasingly on loose policy and debt

Stocks were elevated by buybacks (funded with debt)

— S&P 500 — Corporate profits (before tax with IVA and CCAAdj, USDbn, saar), rhs



Capital was misallocated



Which led to distortions

S&P Growth/Value Index, Jan 1 1996 = 1

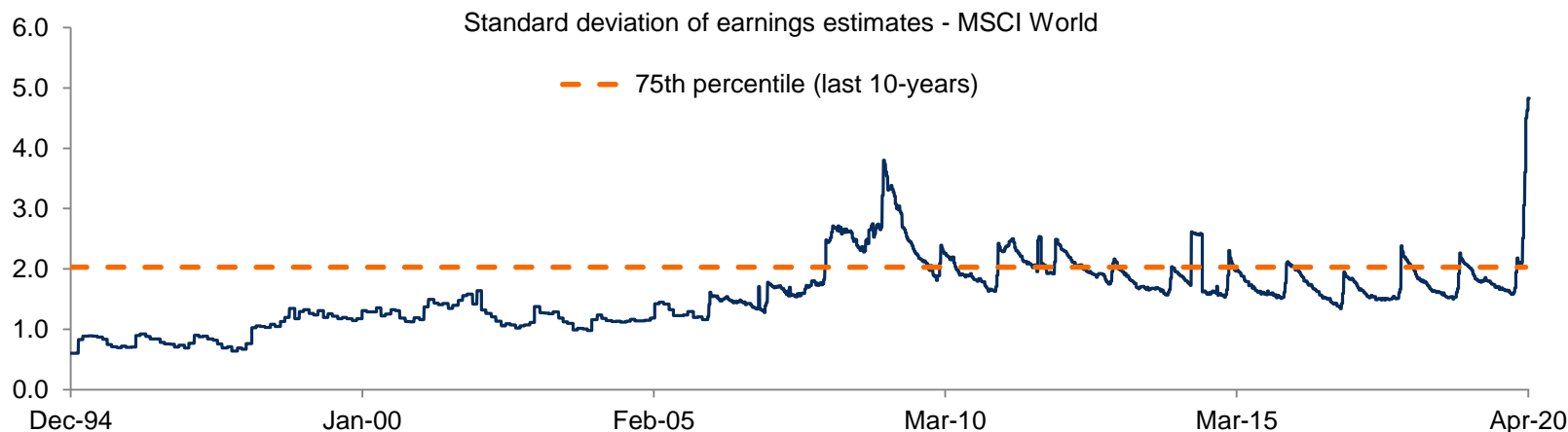


10 Source: State Street Global Markets, St Louis Fed, Banerjee and Hoffman (2018), Bloomberg; data as of 4/20/20

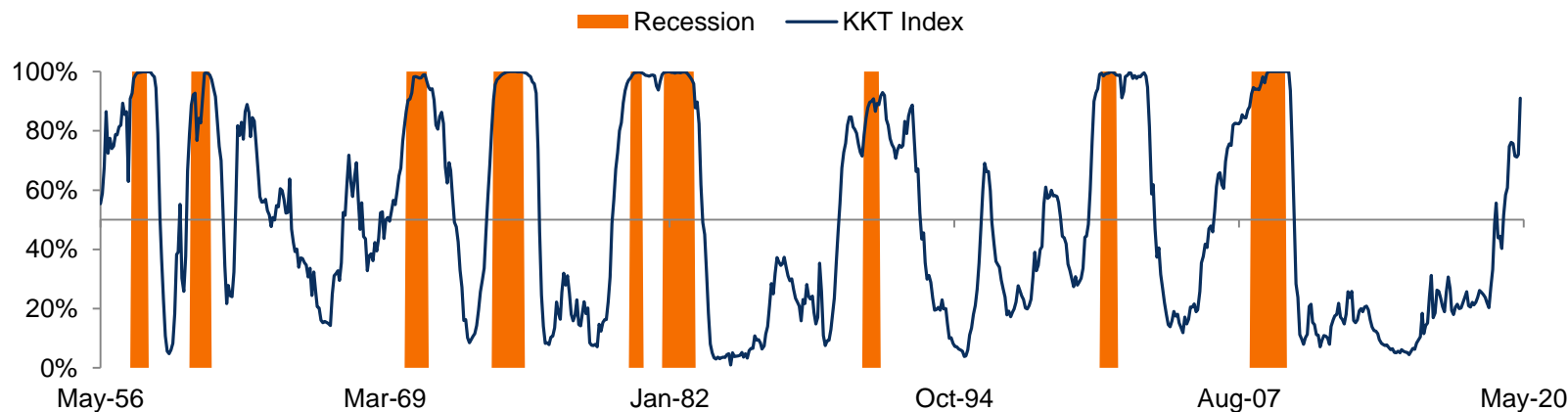
Uncertainty remains extremely high

Earnings disagreement the highest on record

Analysts just can't agree



Our recession indicator is still at its highs

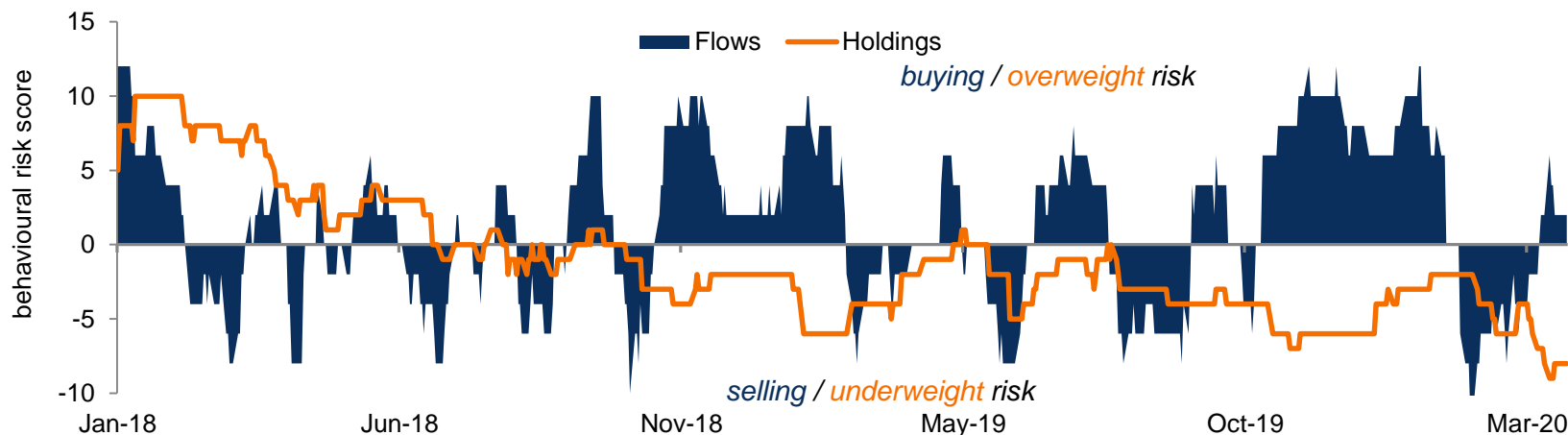


11 Source: State Street Global Markets, Bloomberg; data as of 4/24/20

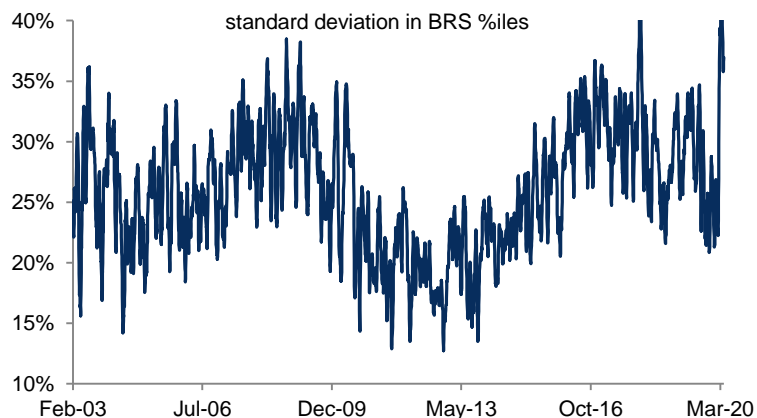
Real money investors cautious but not panicked

FOMO is still a powerful driver

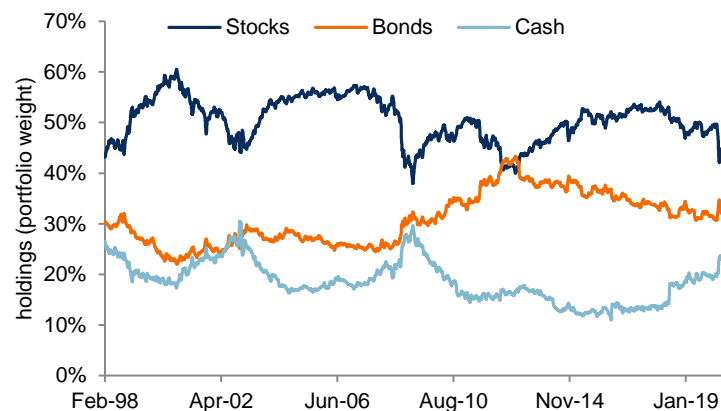
Overall sentiment has held up surprisingly well, now back to positive



But dispersion is close to record highs



Cash holdings have risen but below 2008 levels

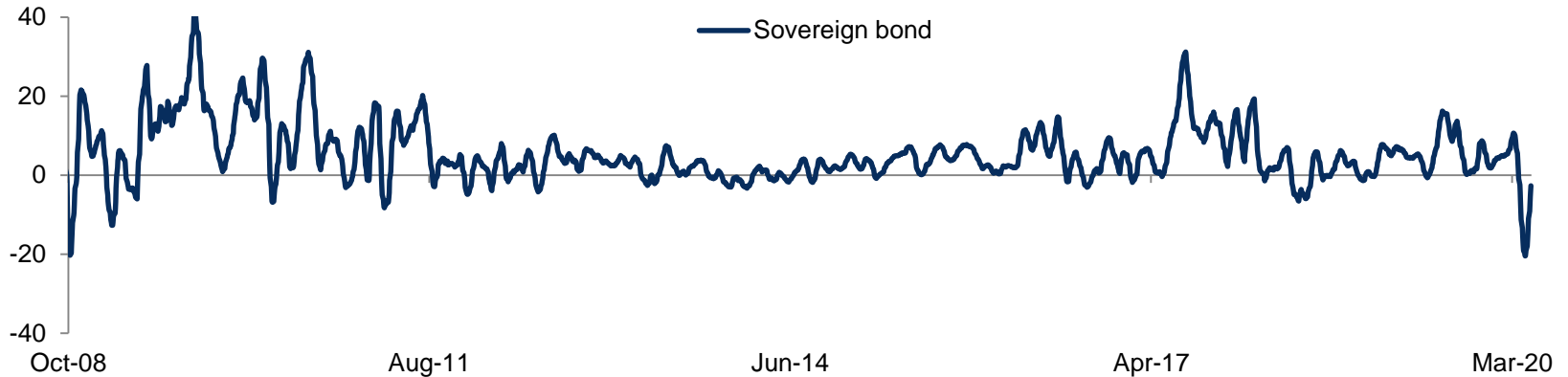


Home bias and weak price pressures

Real money are moving money home and online prices are falling

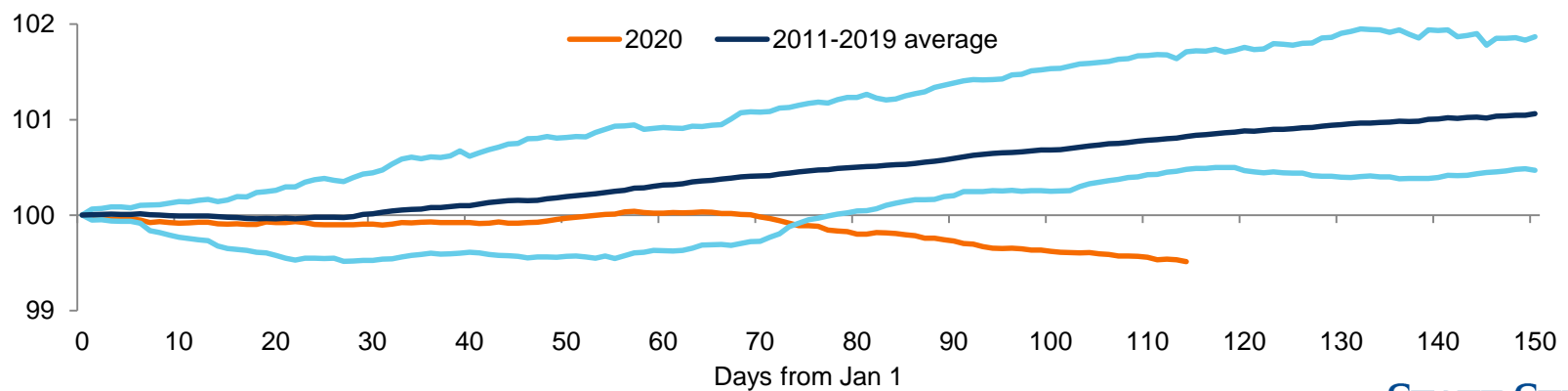
Real money home bias is strong

Total cross-border flows (20d MA, bps of debt outstanding)



Lowest price pressures in PriceStats history

PriceStats Developed Markets with Historic Range



Levels hard to justify

Forward PE the highest in 14 years

Tough to justify

S&P 500 Forward PE

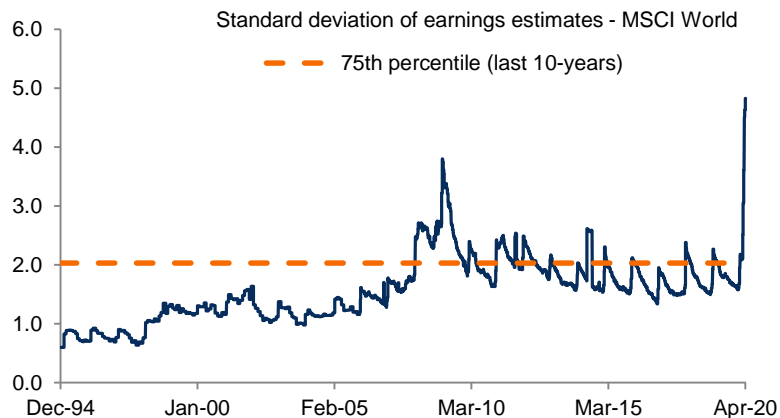


¹⁴ Source: State Street Global Markets, Bloomberg; data as of 4/27/20

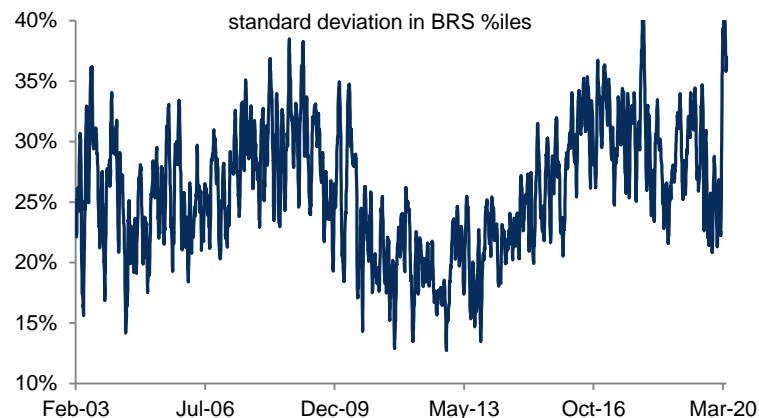
Caution to Repair

Still more work to be done; and Recovery phase still a way off

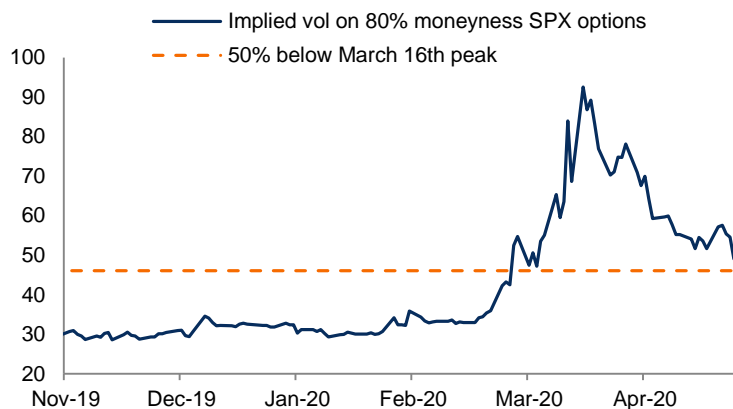
Still rising



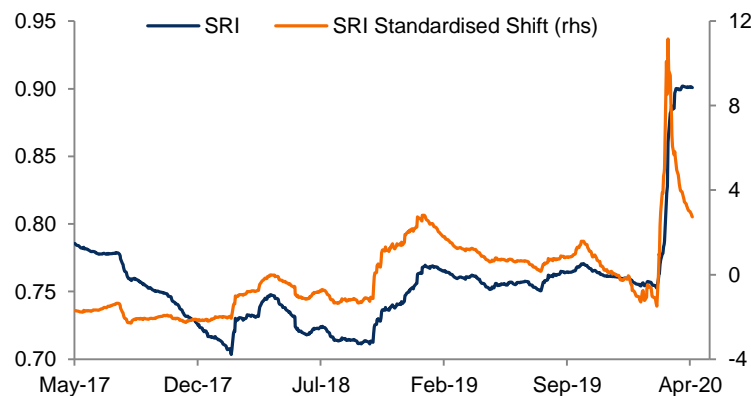
Peaking but elevated



Healing but not yet compelling



Systemic Risk is still rising



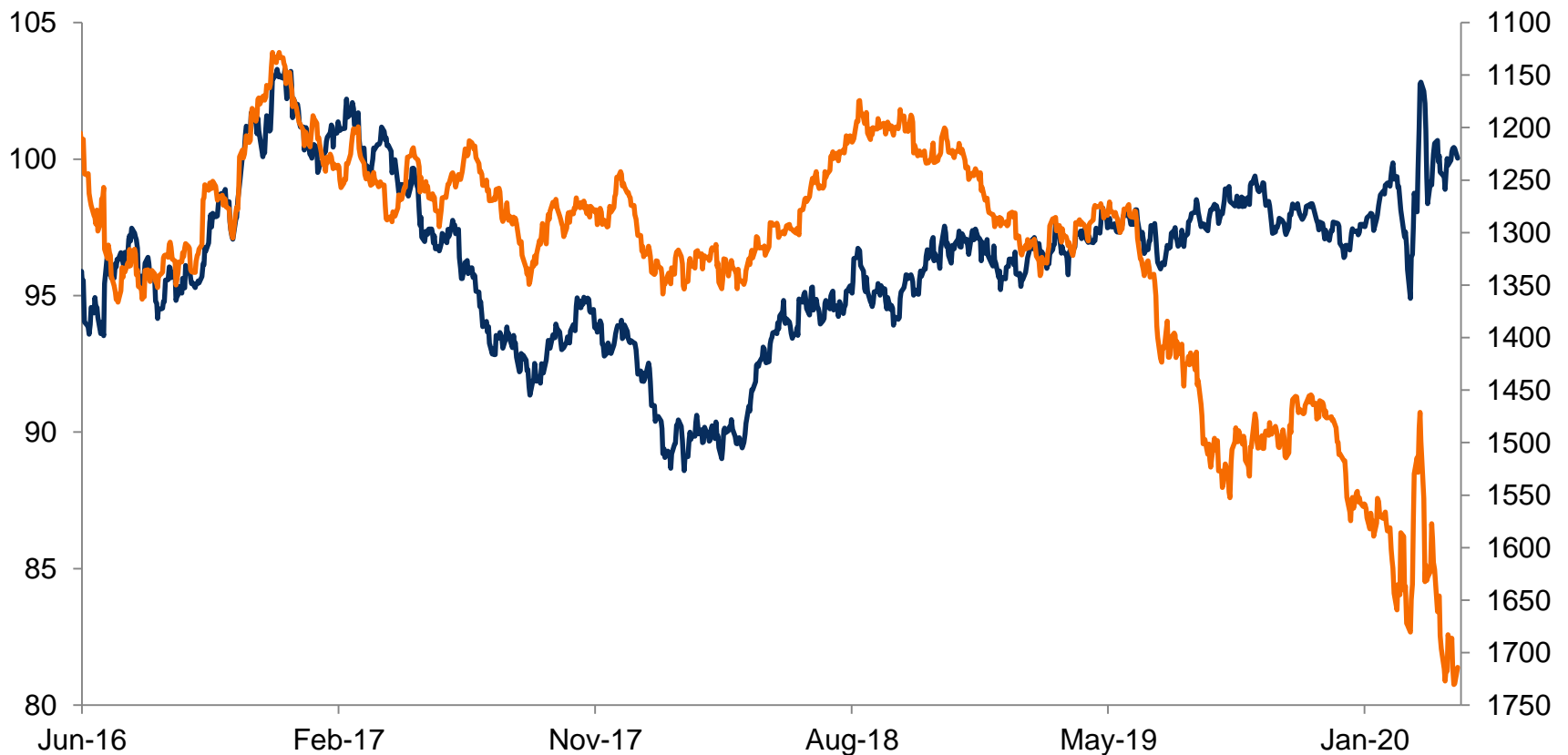
What does it mean for markets

AA decisions: Overweight gold

QE and the demise of fiat currencies

The search for hard assets

— DXY Index — Gold (rhs, inverted)

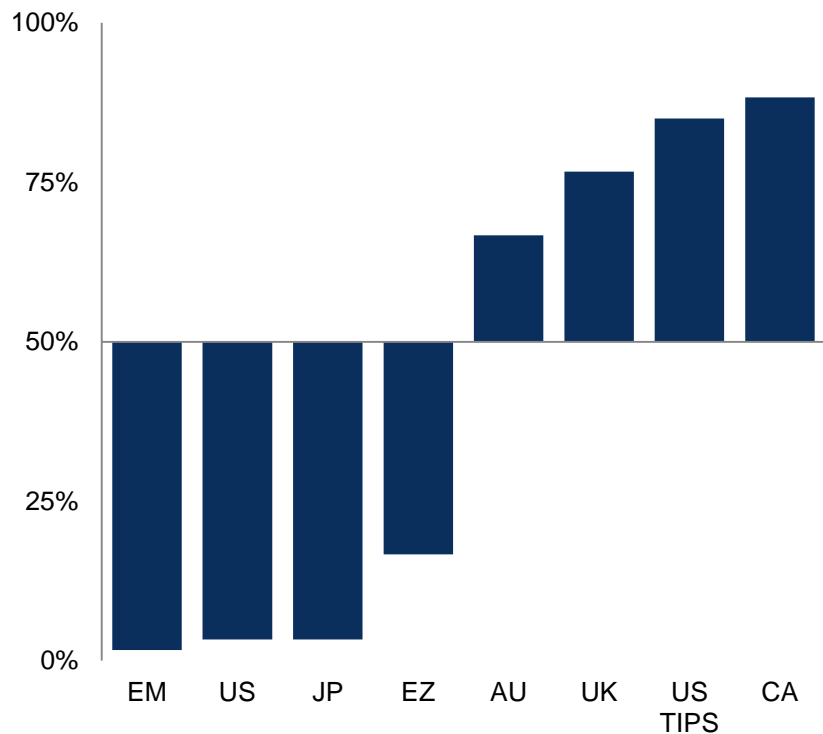


AA decisions: Favour sovereigns

Yields are low but still the safe option

Plenty of underweights to choose from

Sovereign bond holdings (duration unweighted)



The trend is still your friend

US 10-yr yields

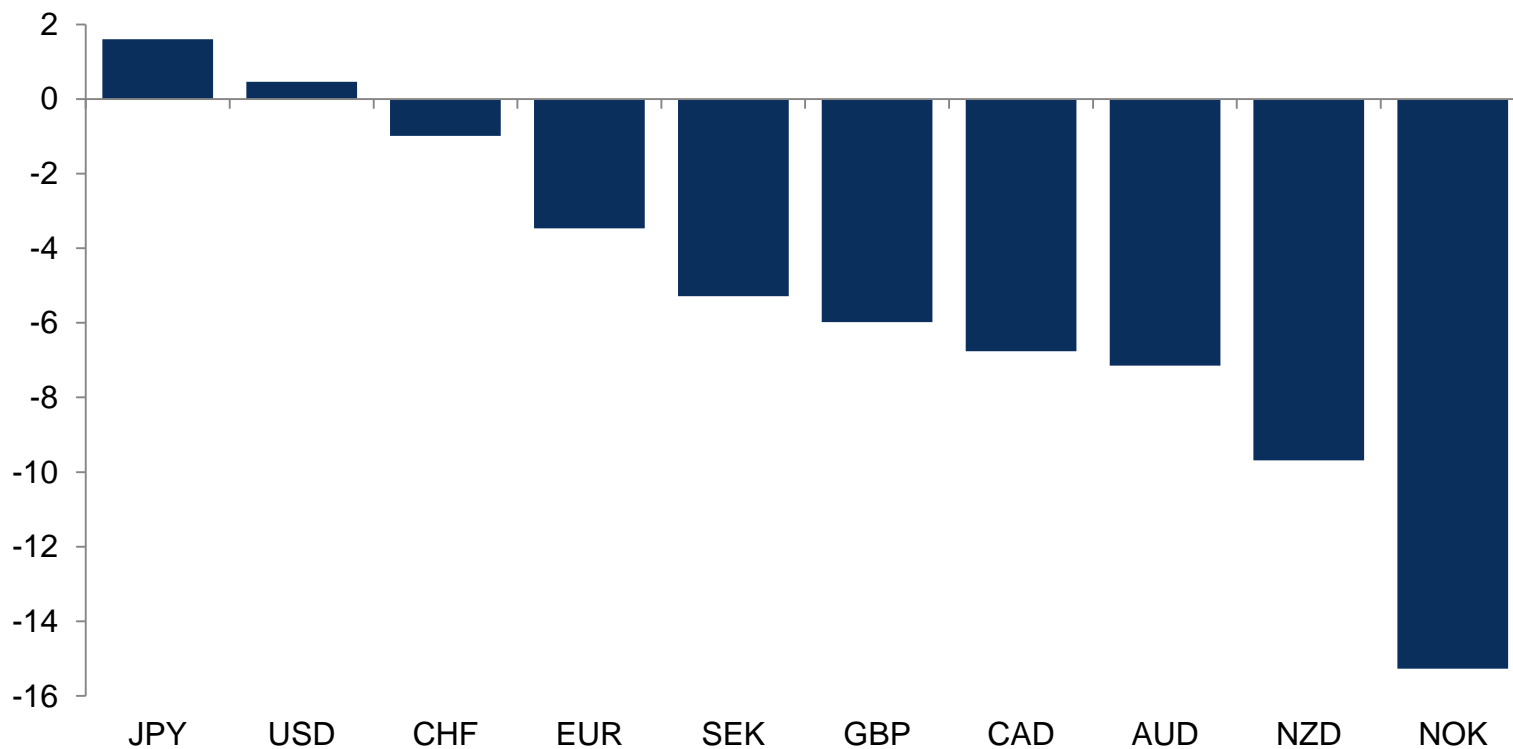


G10 FX doing exactly what it should

Safe havens vs the rest

Set to continue so long as fears remain

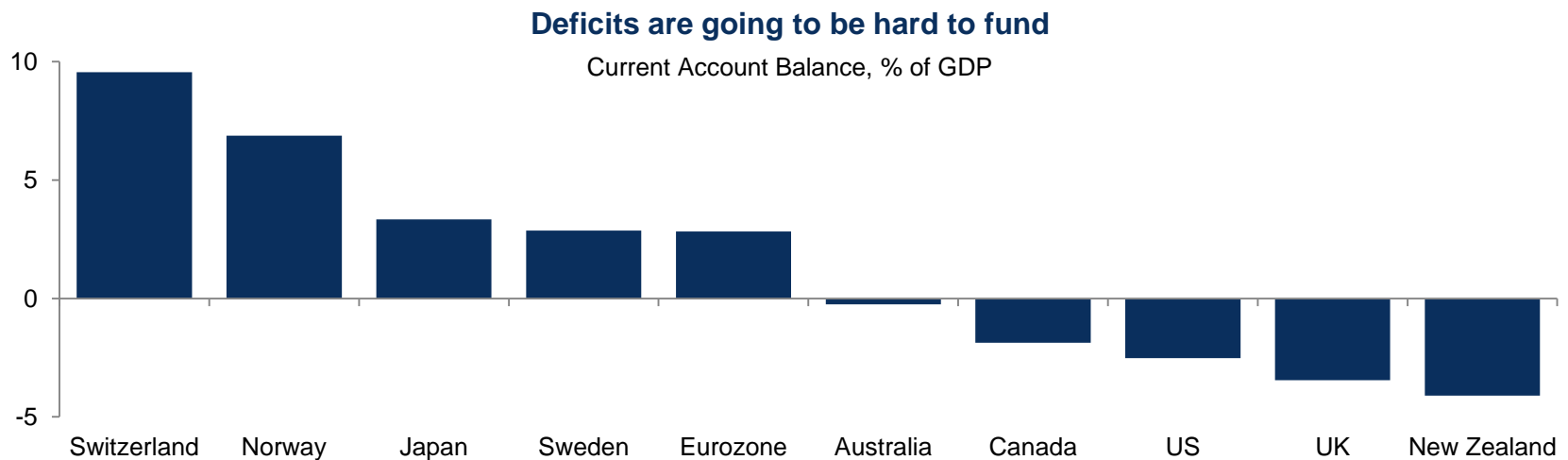
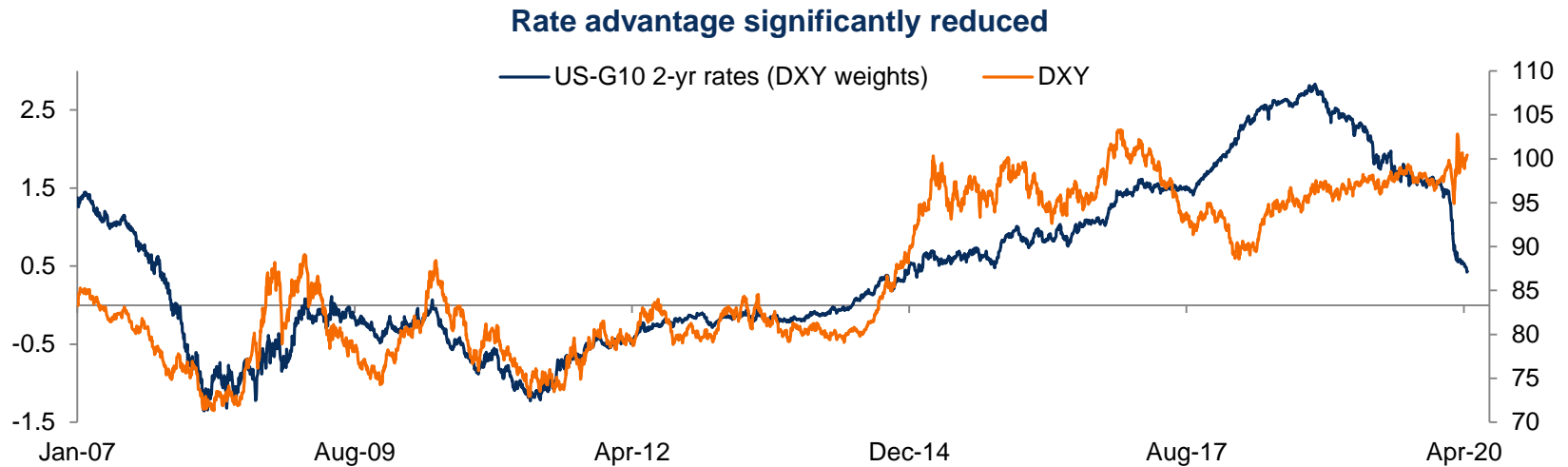
G10 FX performance, ytd, total return, %



19 Source: State Street Global Markets, Bloomberg, As of 4/28/20

USD set to suffer in the coming months

Rate premium largely gone and capital flows will remain slow

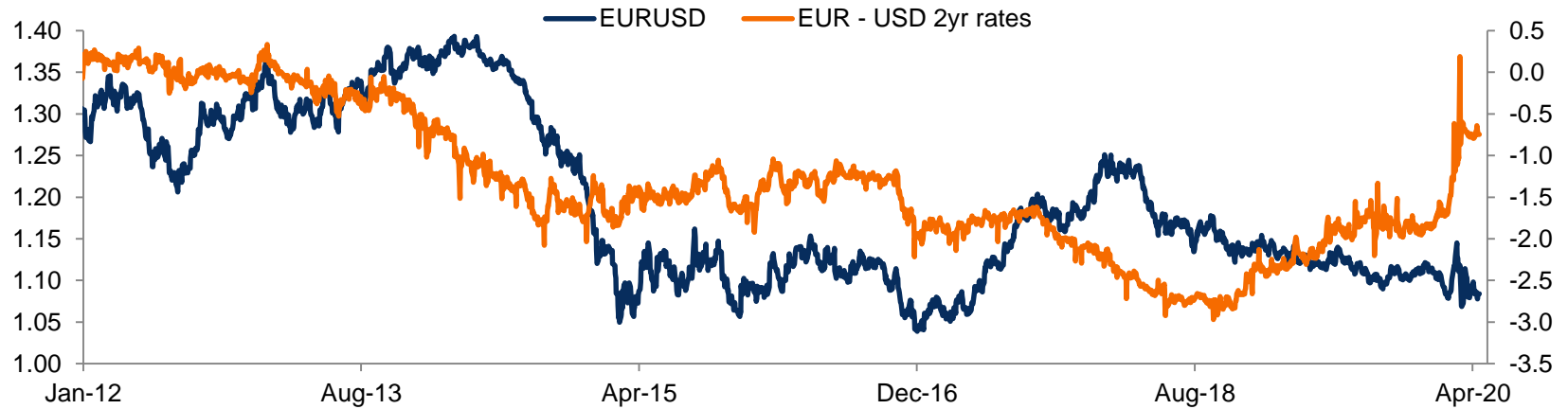


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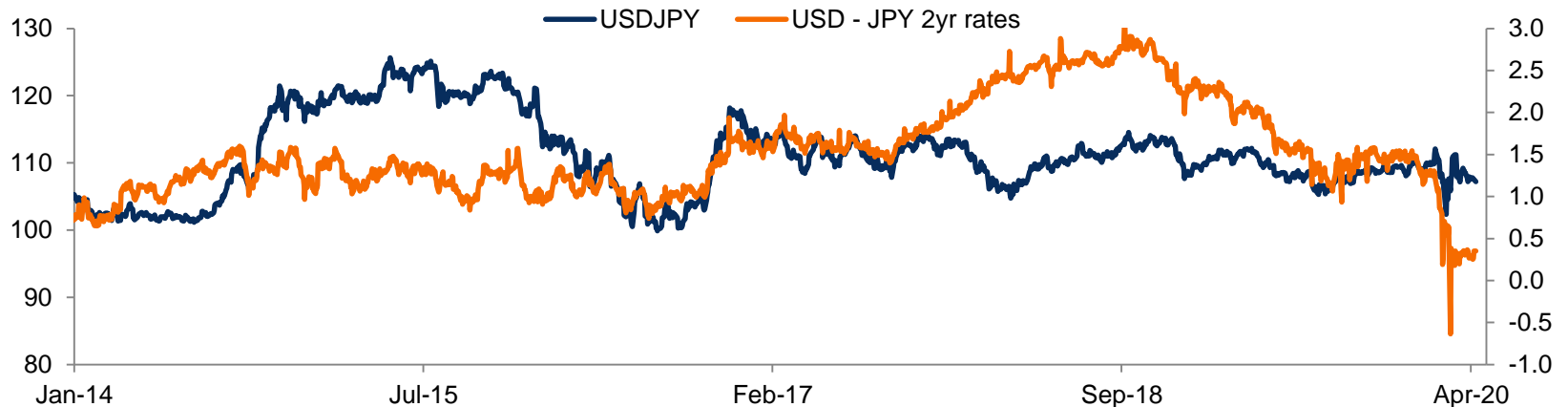
USD: end of an era vs G3

Little rate premium, current account deficit and home bias

No longer a high yielder



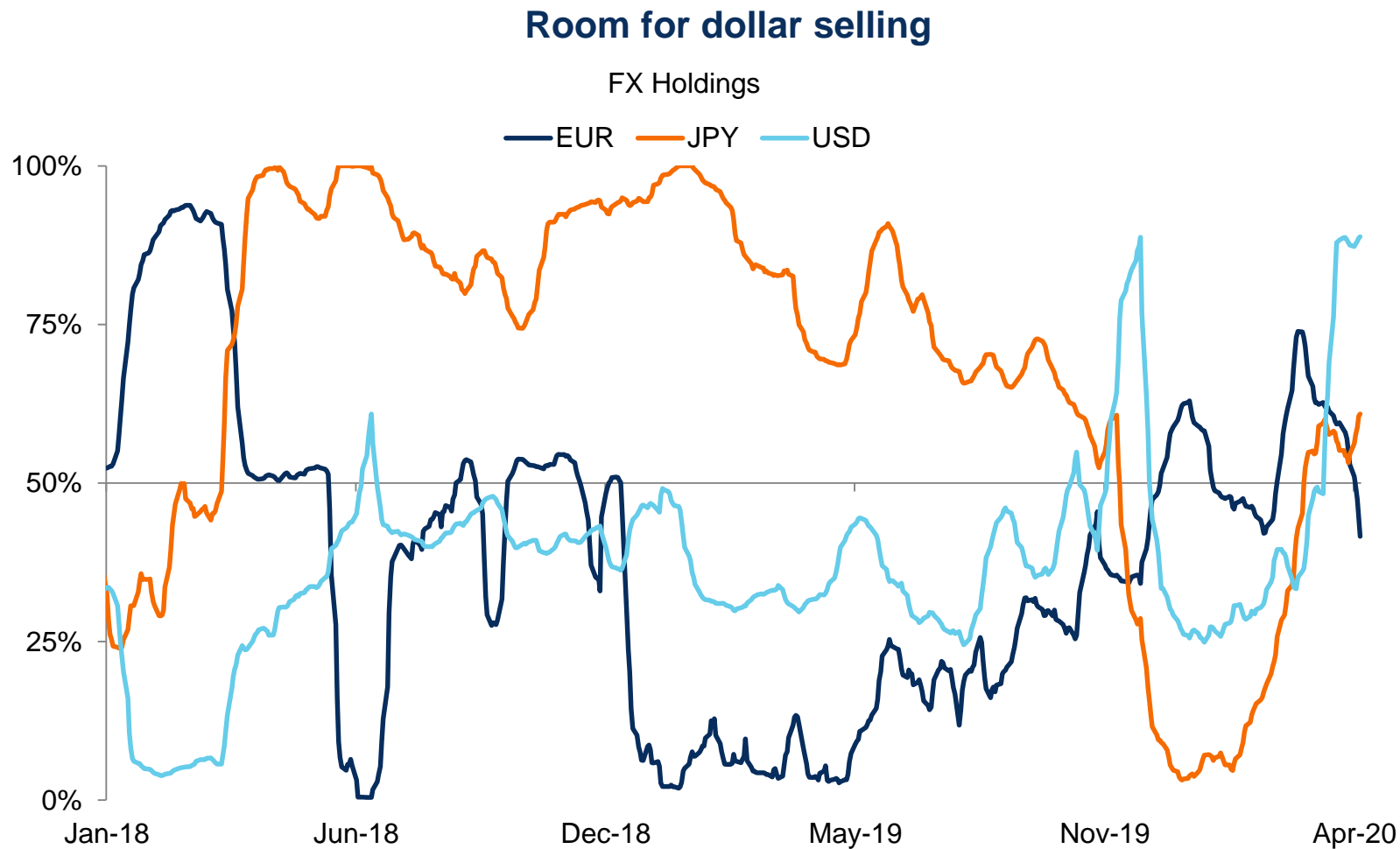
One ultimate safe-haven



21 Source: State Street Global Markets, Bloomberg; data as of 4/27/20

Real money running significant USD overweights

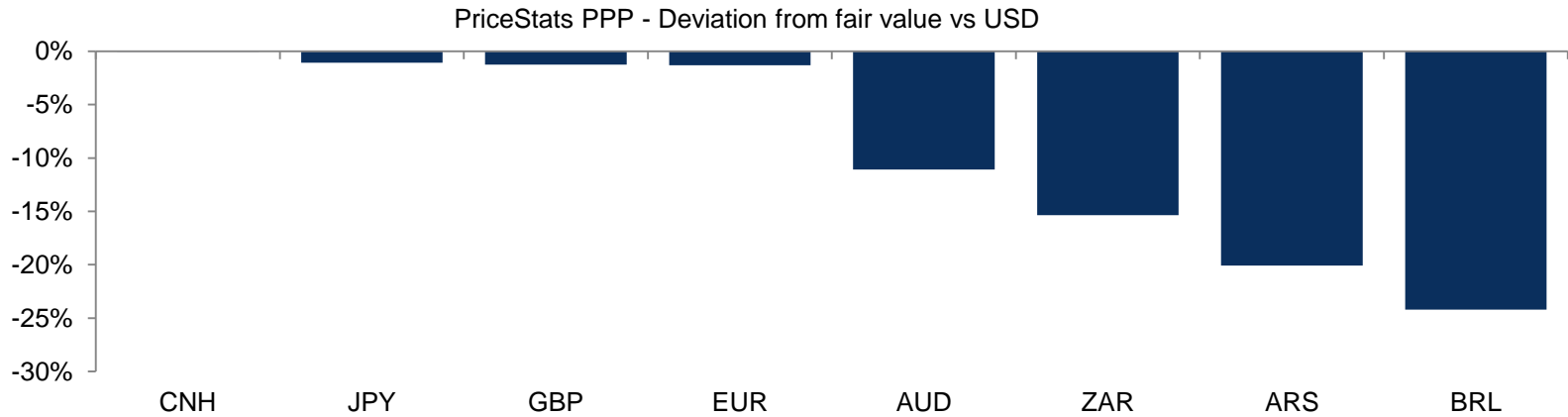
Neutral positioning in EUR and JPY



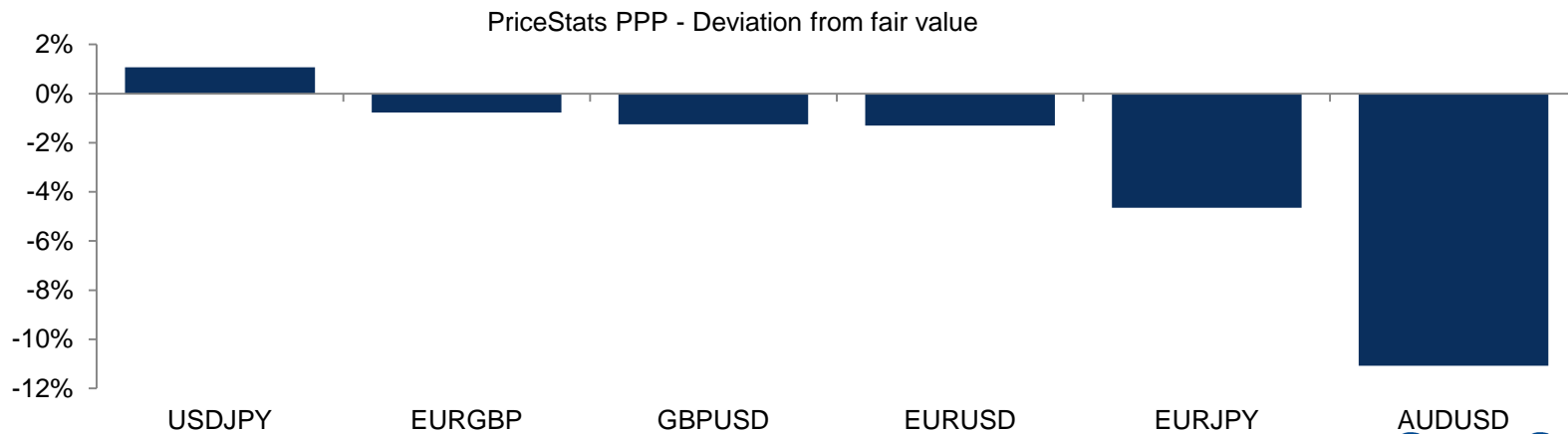
Looking for dislocations in FX

Lots of undervalued EM, but maybe still too soon

Lots of cheap EM



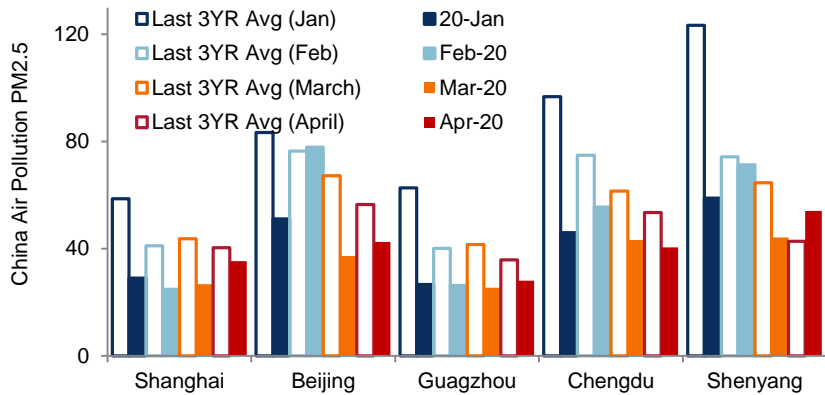
AUD perhaps a better move for now



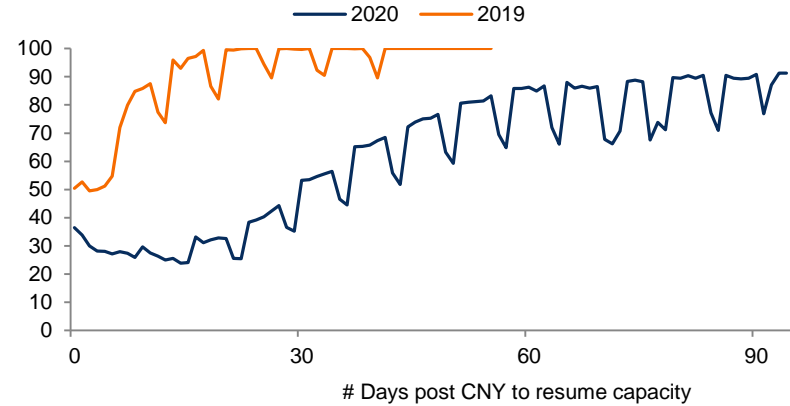
China: A fragmented rebound

Supply shock fading, But concerns over domestic demand

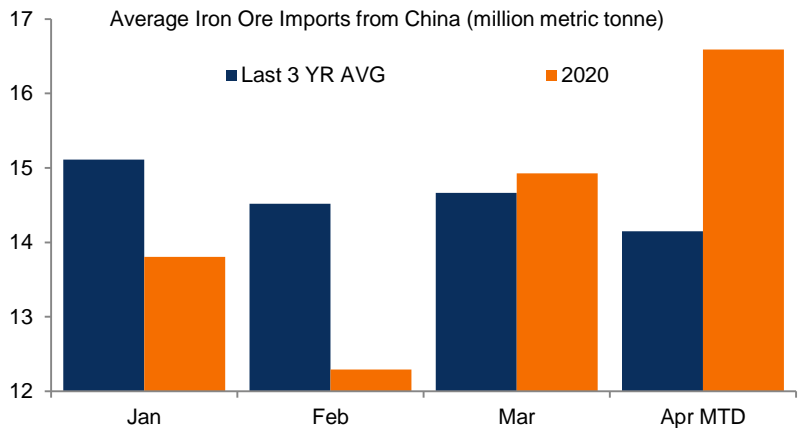
Higher Pollution Indicates More Factory Resumption



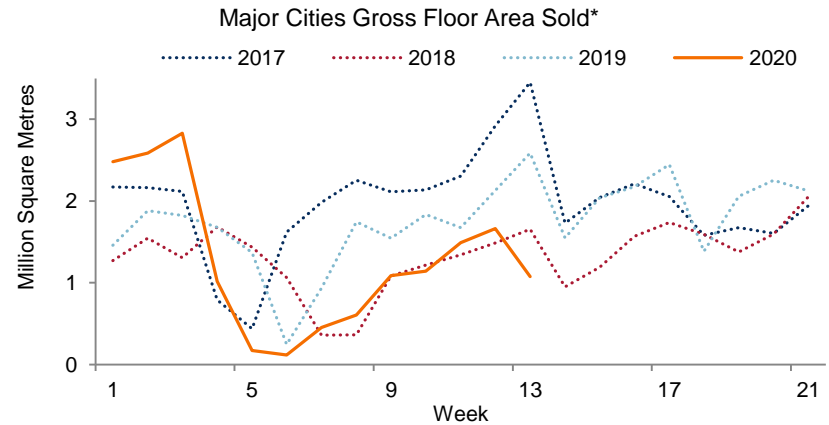
Worker Mobility Improving to 80%



Iron Ore Imports Gaining Momentum



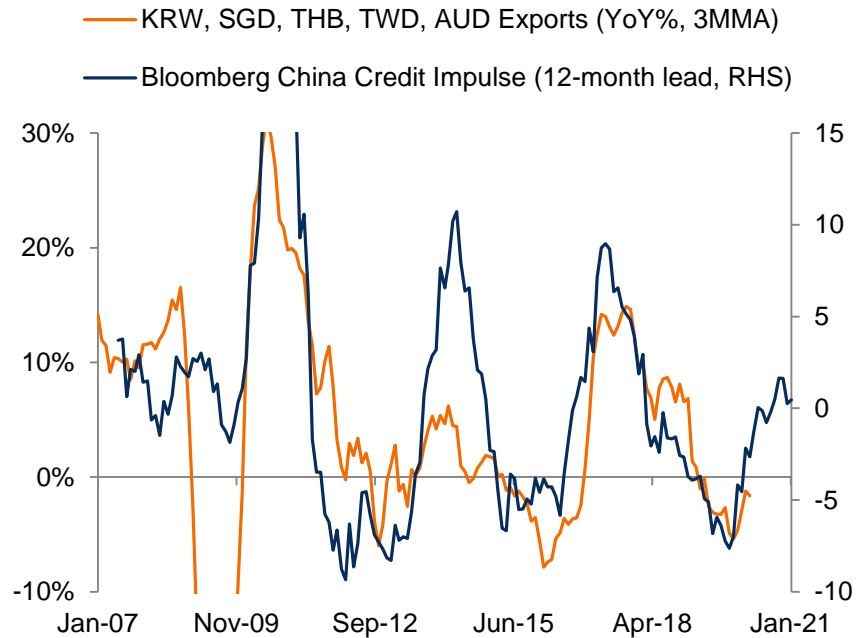
Biggest Concern is Property Sales



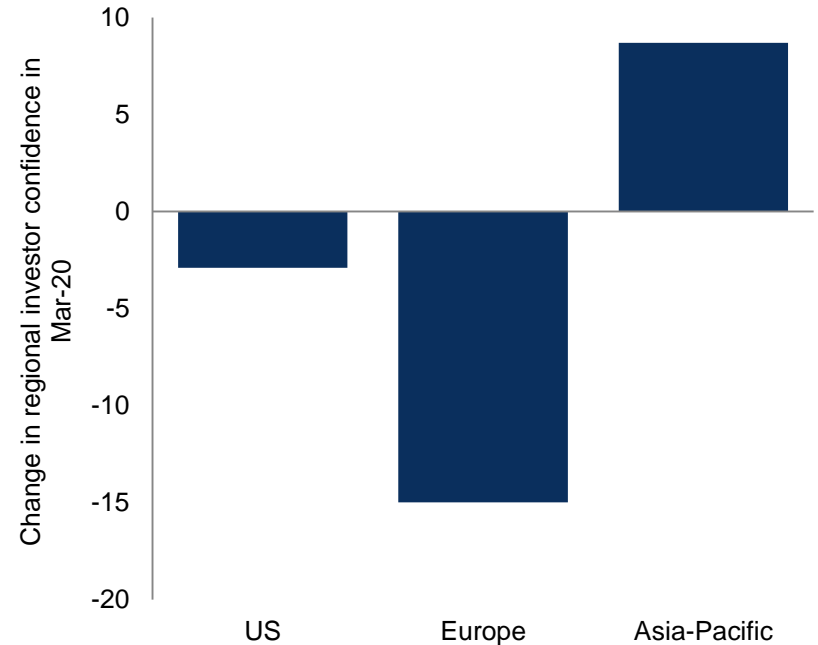
China: A fragmented rebound

Positive spillovers for EM Asia but what about global demand

Believe in China, Believe in Asia?



Regional investor confidence is stronger in Asia



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