



MARKET Commentary

January 2020

Macro View

The coronavirus outbreak in China shook markets mid-January. Markets entered 2020 on an optimistic note following the Phase 1 trade agreement with China and modestly better expectations of global economic activity. As news reports came out of a virus quickly spreading in Wuhan, China, risk aversion replaced euphoria. The virus added a new, uncertain, downside risk for markets just as there were signals that global economic activity was stabilizing. U.S. treasury yields moved sharply lower and the yield curve inverted as expectations of monetary policy easing increased. The global move to safety pushed negative yielding debt back up to almost \$14 trillion by month-end.

The United Kingdom officially exited the European Union on January 31st. The clock starts on the transition or implementation period which runs until the end of 2020. During this time, new trade deals will need to be hammered out (especially with the European Union) as well as other key agreements on law enforcement, utility regulation, immigration, etc. In the interim, the UK will remain in the EU customs union and single market allowing for the free movement of goods and people.

President Trump was acquitted by the Senate along party lines setting up a victory lap State of the Union address after which House Speaker Pelosi tore up a copy of the President's speech. The political theatrics will continue to heat up as Democratic candidates vie to run against President Trump.

Monetary Policy

The Federal Reserve (Fed) met in January and held rates steady. The Fed reiterated its stance that monetary policy was appropriate and expects to remain on hold through 2020. Fed officials downplayed the impact of coronavirus, but acknowledged it could impact global growth and is monitoring the situation. The next Federal Reserve meeting is slated for March 18th. Markets have priced in two cuts, as measured by fed funds futures, in 2020 up from earlier in the year when barely one cut was priced in.

The Fed continues to offer overnight and term repo funding, but is slowly reducing the size of the offerings through February. Look for the Fed to ease back its involvement mindful not to disrupt money market functionality.

Markets

Federal Funds Target
1.50-1.75%

US Treasuries

As of 31-Jan

Benchmark	Yield
3 Month	1.54%
6 Month	1.52%
1 Year	1.42%
2 Year	1.31%
5 Year	1.31%
10 Year	1.51%
30 Year	2.00%

ICE BofAML Index Returns

2020 YTD Return

Index	Return
0-3 Month UST	0.13%
1-3 Yr Gov/Corp ≥ A	0.54%
1-3 Yr Municipals	0.47%
1-3 Yr Agencies	0.43%
1-5 Yr Gov/Corp ≥ A	0.86%
S&P 500	-0.04%

Source: US Treasury, Bloomberg, ICE/BofAML, and S&P

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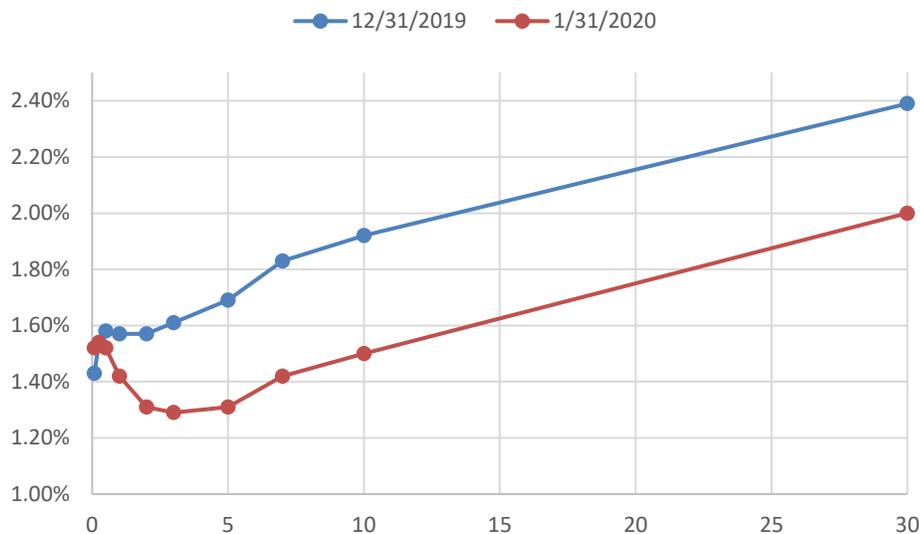
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After closing the year on a high note, the coronavirus outbreak in China sparked a major risk-off sentiment across global markets. Safe haven assets benefited with Treasury yields rallying 20-40 basis points and gold posting a 4.7% gain on the month. The yield curve inverted as the front-end was anchored by Fed policy (on hold for now) and longer maturity yields declined (see Figure 1).

Figure 1: U.S. Treasury Yield Curve Collapses



Source: Bloomberg

Credit performance was mixed over the month. Energy and metals & mining sectors led underperformance as commodity prices cratered (oil down 13%, industrial metals down 7.5% on the month). While BBB-rated and high yield issuers underperformed, their moves were not to the magnitude experienced by equity markets.

The Secured Overnight Financing Rate (SOFR) continued its progress toward broader implementation as Fannie Mae and Freddie Mac announced they will stop accepting LIBOR adjustable rate mortgage loans by the end of the year. Both entities expect to begin accepting SOFR adjustable rate loans by the second half of 2020. Fed officials, including Fed Chair Powell, have recently stressed the importance of transitioning away from LIBOR adding that it's one of the most important challenges facing financial markets. We expect the Fed and regulators to keep pushing to accelerate the rate of SOFR adoption.

Looking Forward

The coronavirus has infected 75,000 people resulting in just over 2,000 deaths. Its 2.5% death rate is far lower than SARS (14%) and MERS (35%). However, China has taken extraordinary measures to contain the outbreak which has hobbled an already weak economy. China's ability to contain the coronavirus will greatly impact market sentiment and the country's impact on global growth (16% of global GDP). The Chinese government will provide monetary and fiscal support to spur economic activity once the worst passes (expected to be about one quarter).

The brief and modest sell-off in corporate spreads offered little opportunity to add exposure. Across high grade sectors, agency mortgage-backed securities, commercial mortgage-backed securities and asset-backed securities look more attractive from a relative value standpoint.

Please contact the desk with questions or to discuss investment opportunities in the coming year.

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