BERGOS BERENBERG

MARKET COMMENTARY

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YESTERDAY'S SELL-OFF: GLOBAL SURGE IN CORONA CASES AND OIL PRICE SHOCK

- **Markets dropped significantly across all segments on Monday, led by a surge in coronavirus cases over the weekend and as differences among OPEC+ members are causing a collapse in oil prices**
- **Trading in the US was halted temporarily as circuit breakers were triggered, while 10-year US treasury yields continued their breath-taking fall down another 20+ basis points to 0.50%**

CORONONAVIRUS SPREADS FURTHER

In our last commentary on the coronavirus (COVID-19), we laid out three possible scenarios describing the potential implications of the epidemic on the economy. In our base case scenario, we anticipated that the number of active coronavirus cases would continue to rise around the world, culminating in May/early June and that the disruption to economic activity would continue until the end of the second quarter. Over the weekend, the situation escalated considerably and the semi-lockdown which Italy has imposed on Lombardy and some nearby regions in the economically strong north of the country goes beyond the disruptions previously anticipated. The serious travel restrictions scheduled to last until at least early April and affecting approx. 16 million people, more than one quarter of the Italian population, weigh on the near-term outlook significantly. Hopefully, the Italian response can at least help to slow down the advance of the virus, giving the Italian health system and the neighbouring countries more time to prepare for a further rise in cases. As the number of coronavirus cases continues to climb, the fear that other parts of the world may have to move in the same direction in coming weeks is affecting markets negatively.

OIL PRICE SHOCK WEIGHS ON MARKETS

Next to a virus-induced economic weakness, the global growth outlook experienced another sizeable shock on Friday resp. over the weekend. At the OPEC+ meeting in Vienna, Russia refused to agree to proposed production cuts and as a response Saudi Arabia significantly lowered its oil price for April delivery, signalling production boosts for an oversupplied market. As a result, oil prices dropped around 25 percent on Monday, with WTI and Brent touching their lowest levels since early 2016, marking the strongest percentage drop in almost 30 years. While lower oil prices usually have a positive effect for consumers and transportation companies, the sharp decline comes at a time of already weaker global growth and as containment measures and travel restrictions are weighing on the outlook for oil demand. We are viewing this as a net negative for the global economy, especially for the oil-producing sector and are reminded of the episode in 2015/2016, when oil prices declined significantly and led to the widening of corporate credit spreads (which impacted the high yield credit space due to its sector composition).

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Earning prospects for energy companies are likely to be lowered and will be a drag on 2020 earnings growth expectations. In addition, profit pressures may induce layoffs and could lead to potential defaults among high-yield issuers in the energy space.

LOWER GROWTH, MORE STIMULUS

As a response to the recent developments, our economists have cut some of their key economic forecasts even further. For the full-year 2020, we now look for a contraction of -0.1% in the Eurozone instead of growth of 0.5% and forecast that the recession in Italy and Germany will be deeper than anticipated a week ago. We maintain our view that economic activity should start to rebound by the end the second quarter or at the beginning of the third quarter as the outlook for the epidemic becomes clearer (our base case). However, the risks are rising that the virus-related hit to growth may turn out to be even more protracted. Conversely, partial lockdowns in more regions could cause a significantly deeper hit to economic activity in March and in the second quarter, followed by a stronger snapback from such depressed levels once such lockdowns are eased. With the sharp decline in rates, bond markets are pricing substantial further rate cuts by central banks. Our bond team is now expecting the US Fed to cut rates significantly at each of the next two policy meetings, possibly bringing rates close to zero by April. In addition to rate cuts, asset purchases could be a further measure to be deployed. The ECB obviously has less room to cut, however, as European policy makers will probably also want to send a signal, a small cut of the deposit rate this week now looks likely. Next to the anticipated central bank actions, President Donald Trump said yesterday night that his administration will ask Congress to pass payroll tax relief and other quick measures.

MARKET REACTIONS AND OUR POSITIONING

The combination of virus induced economic weakness and the oil price shock has led to a significant decline in equity prices, with market participants increasingly pricing a recession. The volatility index (VIX) has surged to levels (>50) not seen in years. On the equity side, we hold on to our neutral positioning as we see a balance between a deteriorated macroeconomic and technical picture on the one hand and attractive cross-asset valuations and extremely negative investor sentiment (a contrarian indicator) on the other. In terms of sectors, we downgraded US and European energy sector to an underweight respectively due to the exogenous oil price shock. At the same time, we downgraded US financials (now underweight) and European financials (now neutral) a notch, also as a response to the developments in the oil market. On the fixed income side we changed our positioning in EUR High Yield to underweight (and remain underweight in USD High Yield) and upgraded Eurozone Peripheral Sovereigns to neutral. We remain long duration with regard to USD investments. On the alternative investments side, we reduced our crude oil positioning as markets are trying to digest the shock from the OPEC+ deal failure and as we do not expect this political issue to be solved in the short-term. In an environment of falling real interest rates and market turmoil, we have increased our Gold position even further (from an overweight to a strong overweight).

TILL CHRISTIAN BUDELMANN

As capital market strategist of the private bank Bergos Berenberg, Till Christian Budelmann regularly comments on events on the international capital markets and examines them in the context of economic and political trends. Since 2004, Budelmann has been responsible for various investment strategies and sits on the bank's Investment Committee. He has been Managing Director since 2013.

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