COVID-19 has the world on edge

What does this mean for short-term fixed income?

March 2020

IN BRIEF

Our thoughts are with anyone who has been affected directly or indirectly from the outbreak of COVID-19. Any comments about the illness are not intended to detract from the human suffering caused by the disease.

- Given the contagiousness of COVID-19 and the interconnectedness of the global economy, the disease has spread to every continent except Antarctica, with hotspots in Mainland China, South Korea, Japan, Italy and Iran.
- COVID-19 has already cut Q1 economic output in China, and as quarantining measures become more widespread across the world, COVID-19 is inevitably going to reduce output globally.
- The prospects of a meaningful curtailment of economic output, including reduced manufacturing and services activity, disrupted global supply chains, and reduced consumption has bled into the market sentiment and caused a sharp downward repricing of risk across asset classes and regions.
- Global earnings are expected to soften as a result of the virus.

The markets are moving fast

- The Dow Jones industrial Average had its largest point drop in history on March 9 at approximately 2,000 points
- Multiple major equity indexes around the world are down double digit percent YTD
- The VIX has consistently closed above 30 for a week (from the end of February 2020 into March 2020), which has not happened since the European Sovereign Debt Crisis of 2011
- Financial conditions deteriorated so much that the Federal Reserve (Fed) cut interest rates 50bps on March 3, which is the first inter-meeting emergency cut since the Global Financial Crisis
- Oil prices have collapsed to approximately $31/bbl on concerns of both lower demand in a slowing macro environment and increased supply after a lack of agreement by OPEC+ members on production cuts
- As a result, the 10-year U.S. Treasury yield is now at 0.56% (as of March 9), the lowest level on record

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- More relevant to front end investors:
  - The 2-year U.S. Treasury yield is now at 0.40% (as of March 9), a level not seen since before the Fed started hiking off of zero in 2015
  - The 3 month U.S. Treasury Bill yield now is 0.36% (as of March 9), which is significantly lower than the Fed Funds rate at 1.00-1.25%

High quality duration still is attractive for front end investors

- The futures market (as of March 9) is approximately priced for a 75bps cut in the Fed Funds Rate by the Fed on March 18
- The Global Liquidity investment team predicts a 50-100pbs of cuts are likely in the near term if market conditions persist; at the higher end of this range, we believe that rates still have room to rally despite a pretty strong rally so far
- We have been disciplined in maintaining duration in our money market funds in anticipation of further policy accommodation since the start of the current easing cycle last year
- We have generally added US Treasuries across our Managed Reserves portfolios
- A long duration position for our Managed Reserves funds has resulted in strong performance during this period of volatility (as measured in net returns QTD)

Liquidity is and always will be the core of what we do

- Our focus in Global Liquidity is to make sure our clients have access to their capital even during difficult markets
- As a proven Asset Manager we have navigated all market environments, including the dot.com crash, 9/11, the Global Financial Crisis and the European Sovereign Debt Crisis
- We have transacted in billions of inflows and outflows across the complex during this period of volatility, while proactively testing our personnel resiliency scenarios
- We have the largest, most diversified money market fund lineup in the industry and can build solutions for any client
- The key to success of our award winning platform is our disciplined investment process
  - Prudent and ample daily and weekly liquidity in our money funds
  - Building cash and US Treasury holdings as needed in our Managed Reserves portfolios
  - Maintaining laddered maturities in our portfolio construction
  - Meticulous credit sizing and vigilant credit surveillance

Contact your J.P. Morgan Representative to learn more.

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