Market update from Thrivent

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Equity markets enjoyed a welcomed respite today from the extreme volatility of the past several days. U.S. markets stayed in a relatively tight range, ending moderately up on the day. Energy was the standout as the benchmark for U.S. oil (WTI crude) surged nearly 25%, recording its largest gain ever. This is attributed to reports that the Trump administration is considering intervening in the oil price war between Saudi Arabia and Russia.

Interest rates declined on the continued buying of Treasuries by the Federal Reserve, which is helping to smooth the functioning of that critical market. Demand for safe assets has soared, with yields edging into negative territory on very short maturity Treasuries, such as the three-month bill. Corporate credit markets continued to be buffeted by selling on concerns over companies' ability to service their debt as segments of the global economy effectively shut down.

Economic data are starting to reflect the slowdown in the United States, with jobless claims spiking to the highest level in four years, outside of a short-term jump in 2017 due to Hurricane Harvey. Unemployment claims likely will continue rising sharply as businesses temporarily shut down amid efforts to mitigate the spread of the coronavirus. Business confidence surveys also have started to fall sharply, reflecting uncertainty over the depth of the downturn.

Meanwhile, Congress and the administration continued to work on a large stimulus package to boost the economy. The $1.3 trillion package reportedly includes payments of $1,000 per adult and $500 per child, with additional payments possible. It also includes payment aid to small businesses and distressed industries such as airlines.

Coronavirus slows to a crawl in China

While the coronavirus continues to spread globally, Wuhan, the Chinese city at ground zero where the virus originated, reported no new cases for the first time since the outbreak began. In fact, growth in new cases in China has slowed to crawl, about .04% yesterday to be precise. China now has more new cases imported from outside the country by travelers than it does originating within. The greatly reduced growth in new Chinese cases is encouraging.

With the slowdown in China, the pandemic's epicenter has shifted to Europe, which now has more cases and deaths than China. The key to watch is if shutdowns and other steps in Europe and the United States produce a similar result of flattening the growth curve. Markets also are closely tracking potential treatments, which if effective, could be game-changing by reducing the impact of the virus. Government and pharmaceutical companies are working feverishly testing drugs, some of which appear promising.

Dash for Cash

Investors have been scrambling to reposition into cash—the equivalent of battening down the hatches to weather the volatility storm. This dash for cash, however, has disrupted the normal functioning of financial markets as investors liquidate assets, deleverage, meet margins calls and reduce risk.

Too many people heading for the same exit clogs up the inner workings of the financial system. Markets strain to efficiently price securities. Sellers outnumber buyers and intermediaries such as Wall Street brokers hit their fill on buying and cannot transfer risk quickly. The plumbing becomes clogged and prices can become disconnected with underlying values, such as Exchange Trade Funds (ETFs), trading at unusually large discounts to the value of their underlying assets. The same is true when high-quality corporate bonds start selling off as much as lower-quality bonds.

What do you do when the plumbing becomes clogged? Call a plumber; in this case, the Federal Reserve and other central banks. The Fed has dusted off its playbook from the financial crisis with an alphabet soup of programs designed to help markets operate efficiently by flooding the system with trillions of dollars in liquidity. This allows brokers, banks and others to access funding. The Fed also is backstopping money market funds to make sure they can meet redemptions for investors and funds. Additionally, the Fed committed to buying $500 billion in U.S. Treasuries and $200 billion in mortgages to push down rates and keep those markets operating smoothly. I expect the Fed will increase its asset purchases further, as more might be needed to calm markets.

Other central banks are taking similar steps, most importantly the European Central Bank (ECB). It announced a substantial €750 billion addition to its government and corporate bonds buying program. By the end of the year the ECB plans to buy an unprecedented €1 trillion in securities, including existing programs.

The combined firepower of central banks works to lower the cost of credit for businesses and households by pushing down rates. Over time, it should unclog the market “plumbing” and help markets operate more efficiently. That in turn should enable markets to better price risk and better reflect underlying value, helping to dampen volatility.

In the meantime, we believe many markets have become dislocated and offer attractive discounted values, not only in equities but also segments of the credit markets.

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