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Weekly Market Commentary - March 23rd, 2020

Investors Flock to Cash as Liquidity Evaporates

- Like most major asset classes, the crypto market has endured tremendous losses over the last few weeks as investors shed risk and flock to cash. Bitcoin, for example, has suffered one its fastest major corrections, dropping 35% over the last 30 days alone.

- After a relatively benign period, volatility blew out across asset classes, triggering a broad repricing of risk in everything from equities to high yield corporates. There aren't many places for investors to hide during a liquidity crisis and even traditional safe havens (i.e. Treasuries) wind up under the guillotine eventually as market participants look to sell anything with liquidity for cash.

- The Fed has joined its major European counterpart in unrestricted QE and an expansion of programs aimed at curbing the bloodbath in financial markets, though its latest announcement seemed to fall on deaf ears. The ball now sits squarely in the court of lawmakers to pass an economic stimulus package comprehensive enough to tackle the mounting economic issues standing right in front of us.

Lead Analyst

Kevin Kelly, CFA

kevin@delphidigital.io

Chart of the Week

Bitcoin continues to trade more in line with risk assets than safe havens, staying true to its historical precedent during periods of extreme market volatility. Crypto assets in general are still largely viewed further out the risk curve than safer, less volatile alternatives, especially when volatility spikes across financial markets. Additionally, many crypto assets have at least some liquidity, making them vulnerable victims in a liquidity crisis that takes few prisoners.

Bitcoin (Orange) vs. S&P 500 Futures

Sources: TradingView, Coinbase, CME Group

A Lot of Pain to Go Around

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Judging by today's price action, it appears we're in for another long and volatile week as markets continue to digest an onslaught of headlines related to the global COVID-19 pandemic. The situation here in the U.S. seems to be worsening by the day with the total number of cases breaching 40,000 (at the time of writing) compared to less than 100 just a few short weeks ago. While the rapid rise isn't too surprising for those keeping pace with the latest developments, it has undoubtedly raised concerns for everyday citizens now facing mandated social distancing and mass business closures. Much of the violent price action we've seen in markets also goes well beyond your average investor selling stocks for cash. After a relatively benign period, **volatility blew out across asset classes, triggering a broad repricing of risk in everything from equities to Treasury bonds.** A sudden rise in volatility also forces funds to trim or slash the size of their positions, adding more selling pressure to an already frantic market. On top of that, some of the world's largest market makers have pared back trading activities as the rise in funding costs squeeze margins on strategies they employ, resulting in less liquidity and even greater price fluctuations.

The rise of rules-based investment strategies deserves some of the blame as large funds (including those with critical market-making arms) are forced to sell assets across their portfolios per pre-determined mandates. There's much debate over the amount of influence such actions have on markets, but one thing is certain: **liquidity has dried up faster than just about anyone anticipated.** And there aren't very many places for investors to hide during a liquidity crisis. Every asset class finds itself on the guillotine as market participants look to sell anything with decent liquidity for cash. But liquidity all but evaporated from some of the most active markets, including Treasuries, adding fuel to the panic fire. **Crypto assets are still viewed further out the risk curve than safer, less volatile alternatives,** especially when volatility spikes across financial markets. Additionally, many crypto assets have at least some liquidity, making them vulnerable victims in a liquidity crisis that takes few prisoners.

Major Asset Class % Change Since Feb. 19th

Data as of March 23rd, 2020

Source: TradingView, Coinbase, BlackRock, MSCI, SPDR

The Fed Goes Full Send

The Fed joined its euro area counterpart (ECB) with its announcement of **“unlimited” asset purchases and an expansion of programs** – some of which we saw implemented following the GFC – aimed at curbing the bloodbath in financial markets. Market reactions to the Fed’s announcement have been mixed; riskier assets (stocks, high yield corporates) initially rose but have since faded the news while **investment-grade bonds jumped more than 5%** on the back of the Fed’s expanded mandate (which now includes high-grade corporate debt). Notably, **BTC continues to trade more in line with risk assets than safe havens,** staying true to historical precedent during periods of extreme market volatility.

We must also recognize, however, the **limitations of monetary policy in today’s environment.** Businesses around the world are now facing a major exogenous shock to sales as state-wide shutdowns and mandatory “social distancing” force citizens to stay indoors, shifting their consumption patterns for the foreseeable future. Aggressive rate cuts and massive asset purchases only go so far, especially given where we are in the credit cycle.

The ball is now sitting squarely in the court of lawmakers to pass an economic stimulus package comprehensive enough to start tackling these issues head on. **Look to the market to pass judgment on whether their efforts have gone far enough…**

BTC vs. S&P 500 Futures

Data as of March 23rd, 2020
Source: TradingView, Coinbase, CME Group

Corporate Bonds Now on the Menu

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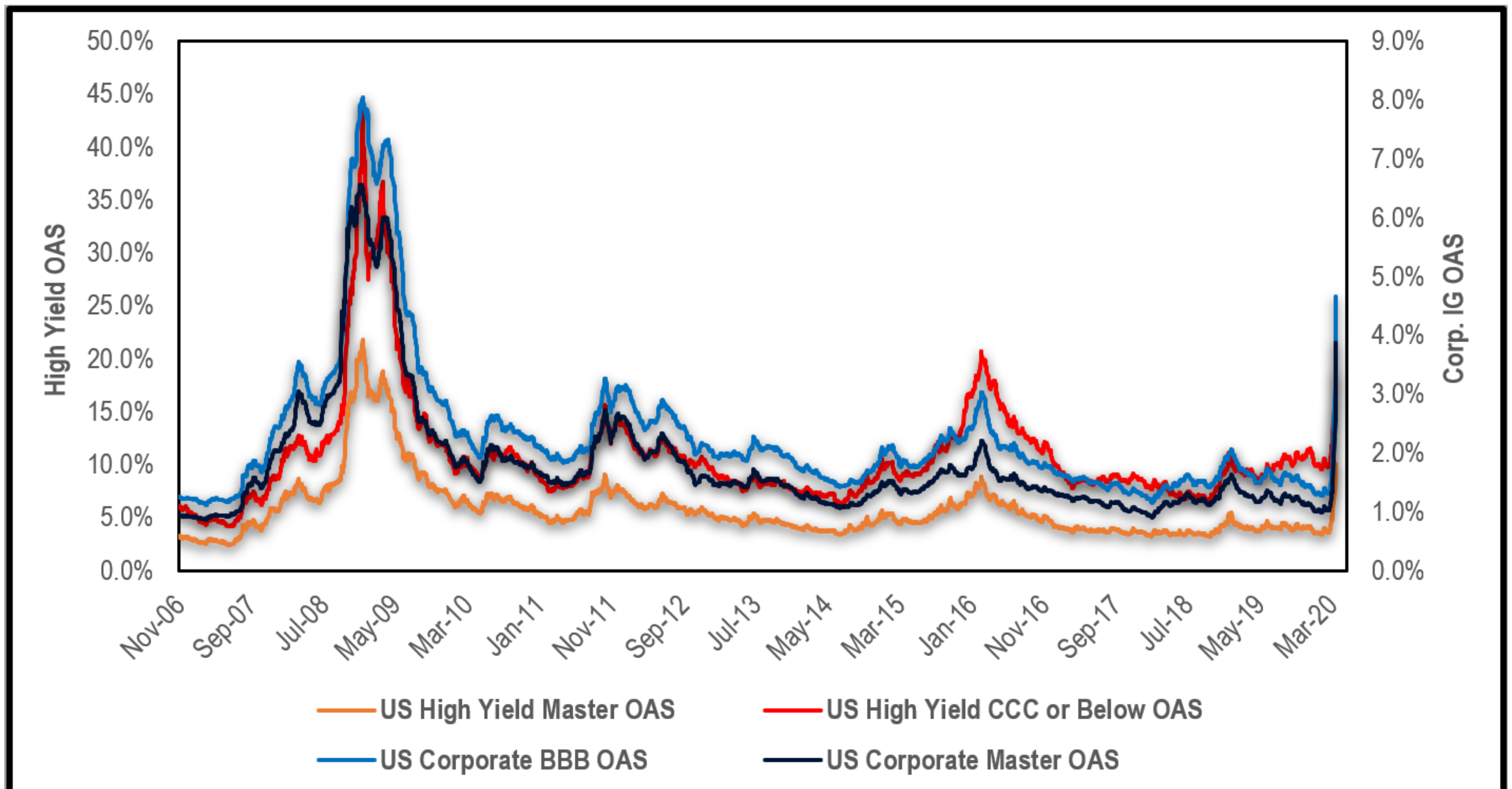
Arguably the most critical detail from the Fed's release this morning was its **expansion into the corporate debt market,** which has been plagued by minimal liquidity and a dramatic shift in sentiment among its primary investor base. The Primary Market Corporate Credit Facility (PMCCF), for example, provides a funding backstop for investment-grade issuers struggling to attain financing during such a tumultuous time. The Fed's ability to now buy corporate bonds is noteworthy as it **recognizes the growing liquidity issues across most asset classes.** Again, in a debt-driven economy, **credit conditions and availability are paramount** to avoid (or at least mitigate) mounting recessionary risks. Financial conditions have tightened considerably in such a short period time, placing greater pressure on lawmakers to pass a desperately needed fiscal stimulus plan ASAP.

U.S. Corporate Investment-Grade & High Yield Option-Adjusted Spreads (OAS)



"The SMCCF will purchase in the secondary market corporate bonds issued by investment grade U.S. companies and U.S.-listed exchange-traded funds whose investment objective is to provide broad exposure to the market for U.S. investment grade corporate bonds." -- Fed's Press Release (3.23.20)

Data as of March 20th, 2020

Source: ICE, Bank of America, Federal Reserve

The Fed's Failed Rescue Efforts

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Policymakers at the Fed have been hard at work throwing everything they can at the market hoping one of its policies will help stop the bleeding, but so far all it's done is caused more panic and concern. Initially, the Fed instituted an "emergency" 50 bps rate cut back on March 3rd as the severity of the coronavirus outbreak came into focus, but **investors merely took that as confirmation of worsening conditions rather than reassurance the Fed could once again save markets from collapsing.** The real driver of the Fed's aggression has been to pump liquidity back into the system and ease mounting pressure in global funding markets before this liquidity crisis becomes a full-blown financial crisis. **Credit conditions are among the most important indicators to monitor going forward as the duration of state-wide lockdowns and social distancing remains unclear.** The longer the economy is stalled, the higher the risk of more serious economic consequences.

S&P 500 vs. Fed Funds Futures (Continuous Contract)

Data as of March 23rd, 2020

Source: TradingView, CBOT, CME Group

Bitcoin Craters as Panic Sets In

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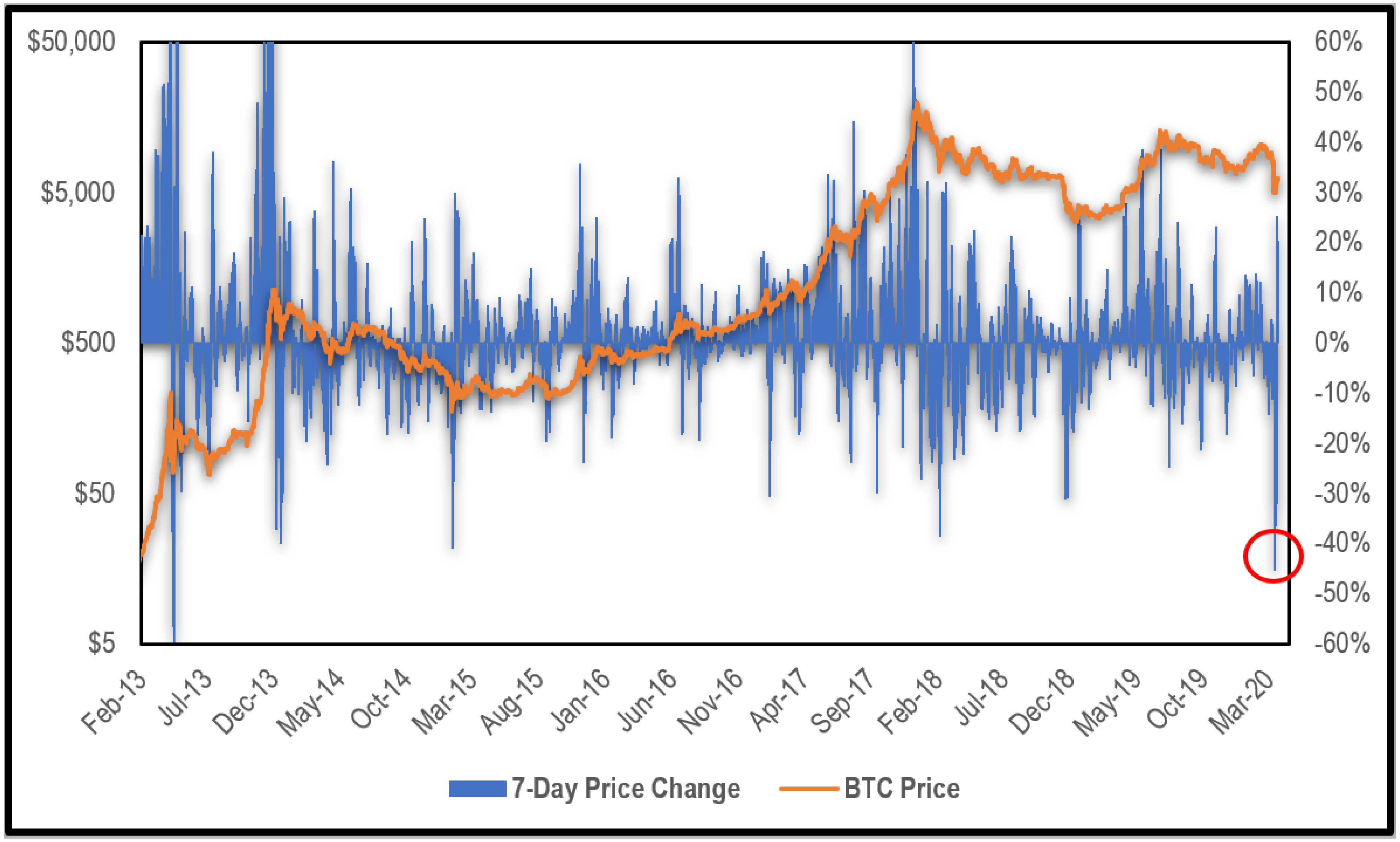
So how's BTC holding up in all this? I mean, it's the ultimate hedge against financial disruption and massive monetary (and fiscal) stimulus, right? Well, long-term it certainly offers such potential, but in the short run BTC too has suffered one its fastest major corrections, **dropping 35% over the last 30 days.** The silver lining (because, let's be honest, we're all reaching for one) is there's a noticeable increase in institutional participants and sophisticated investors (global macro funds, family offices, etc.) this time around. Keep in mind, however, as bitcoin and other crypto assets make their way into institutional portfolios, the **more likely they are to be subject to financial market disruptions and similar liquidity crises.**

BTC vs. 7-Day Price Change (%)



Data as of March 22nd, 2020
Source: Digital Assets Data

Stocks' Historic Week

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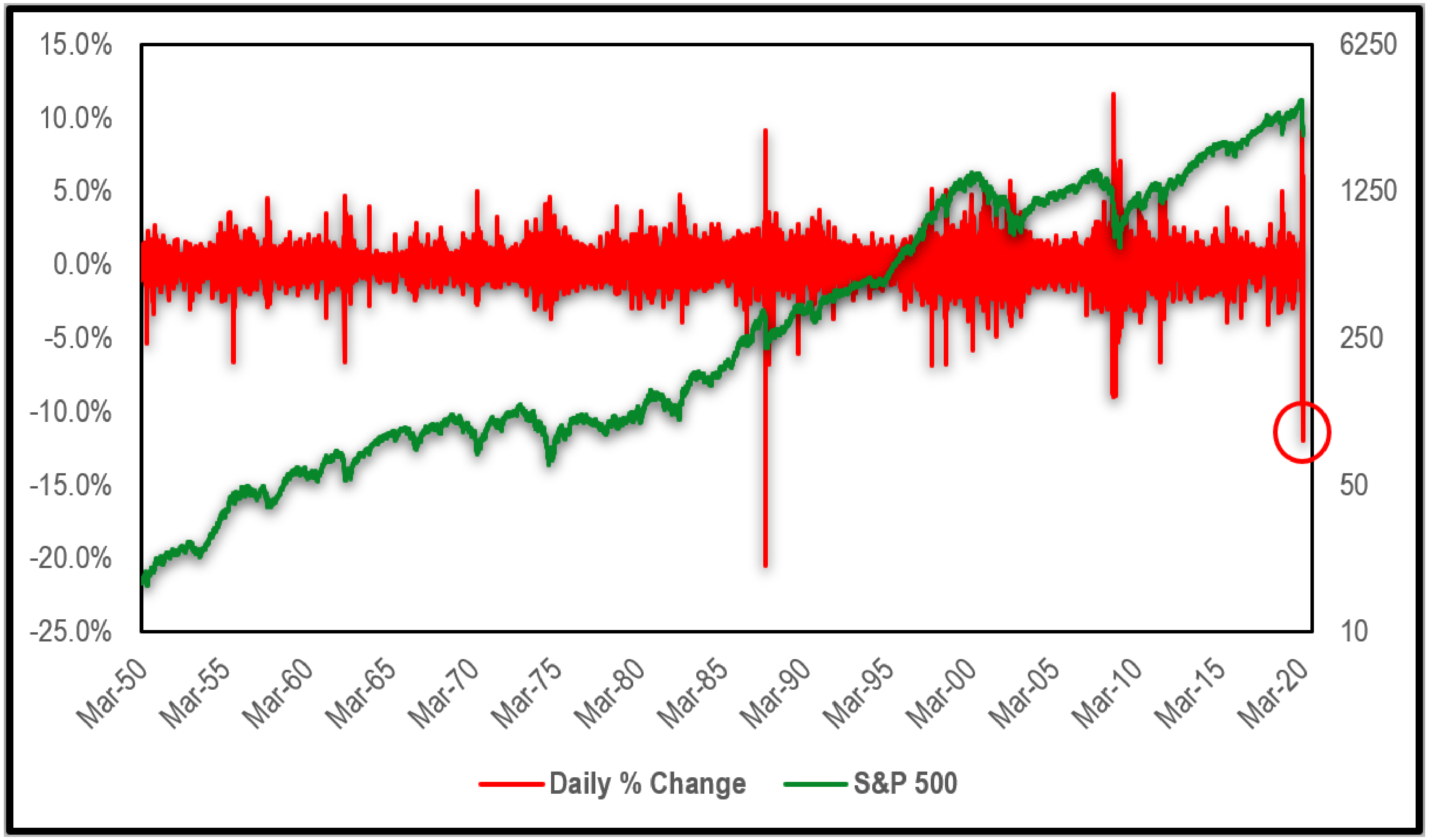
The U.S. equity market is in shambles after four weeks of seemingly non-stop news flow and pessimism towards companies struggling to survive in this new (hopefully transitory) world of mass isolation. Concerns over corporate cash flow and mounting debt obligations have caused major selling in every corner of the equity market; value, growth, min. vol, “defensive” sectors – everything is down, and down big. The SPDR S&P 500 ETF (SPY) saw its **largest gap down at the open last Monday since the ETF began trading almost 30 years ago.** The U.S. equity benchmark **plummeted 12% that day, its third worst daily decline in at least the last 90 years**. The index is now **~34% off its all-time high** set just over a month ago, marking one of the sharpest, most volatile corrections in its history.

S&P 500 vs. Daily % Change



Data as of March 23rd, 2020
Source: Bloomberg

Worst Week Since 2008

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The S&P 500 **fell 15% last week, marking its worst weekly decline since October 2008.** Notably, two of the last three weeks were the worst weekly declines for the S&P 500 since the financial crisis as volatility becomes commonplace across financial markets. The latest drop in equities also closed out the **worst 4-week period for the U.S. benchmark in at least 50 years.**

S&P 500 Week-Over-Week % Change (Bottom Panel)

Data as of March 22nd, 2020
Source: TradingView

Stocks Take Elevator Down

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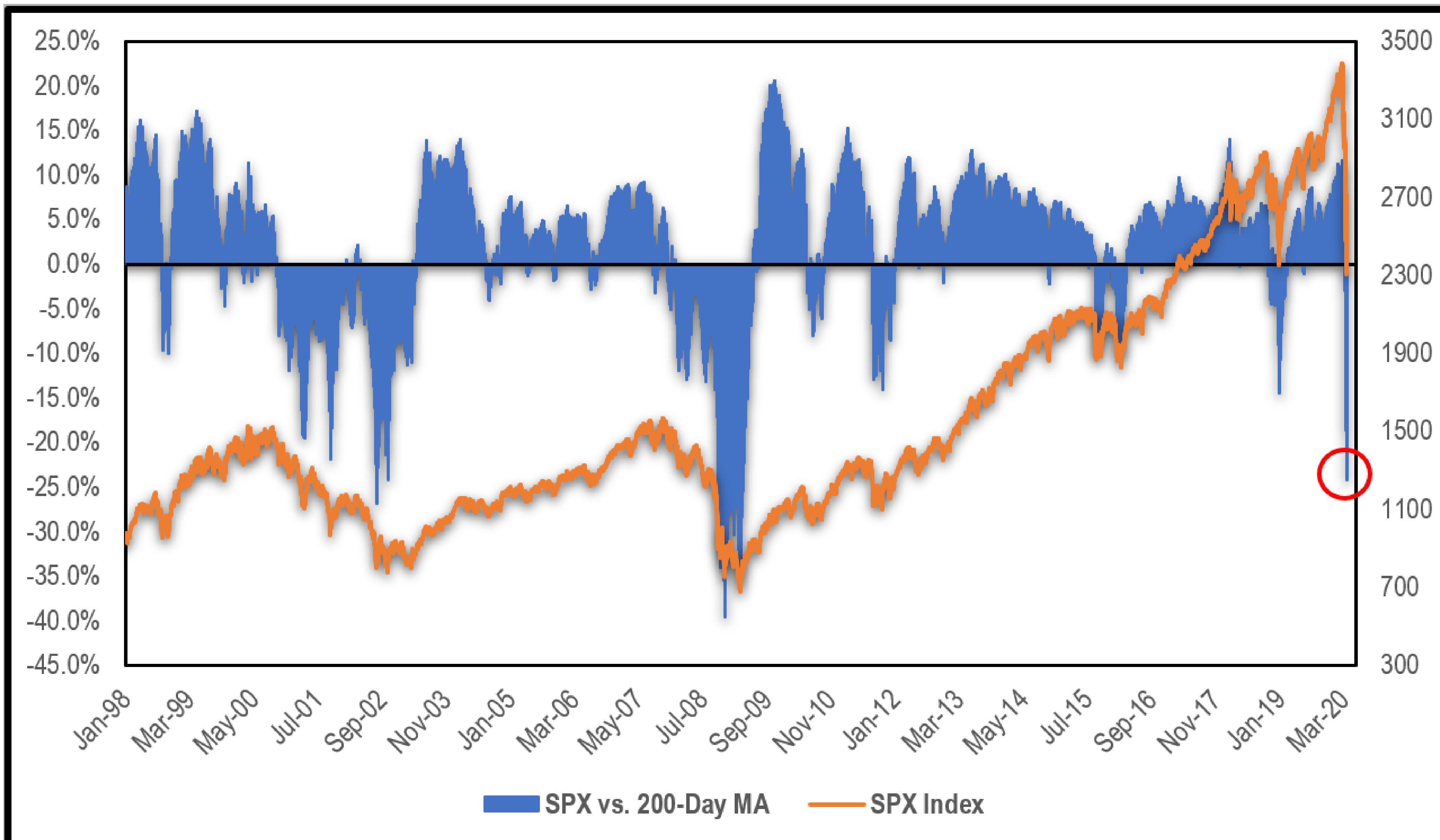
The S&P 500 is trading at its lowest level in more than three years following its latest sell-off, breaking below both its December 2018 low and 200-week moving average for the first time since September 2011. The index is trading **25% below its 200-day moving average,** the widest spread since March 2009. Interestingly, the S&P 500 is now the **most oversold it's been on a 14-week RSI basis since October 2008.**

S&P 500 vs. 200-Day Moving Average



Data as of March 22nd, 2020

Source: Bloomberg

Volatility Spike Wreaks Havoc

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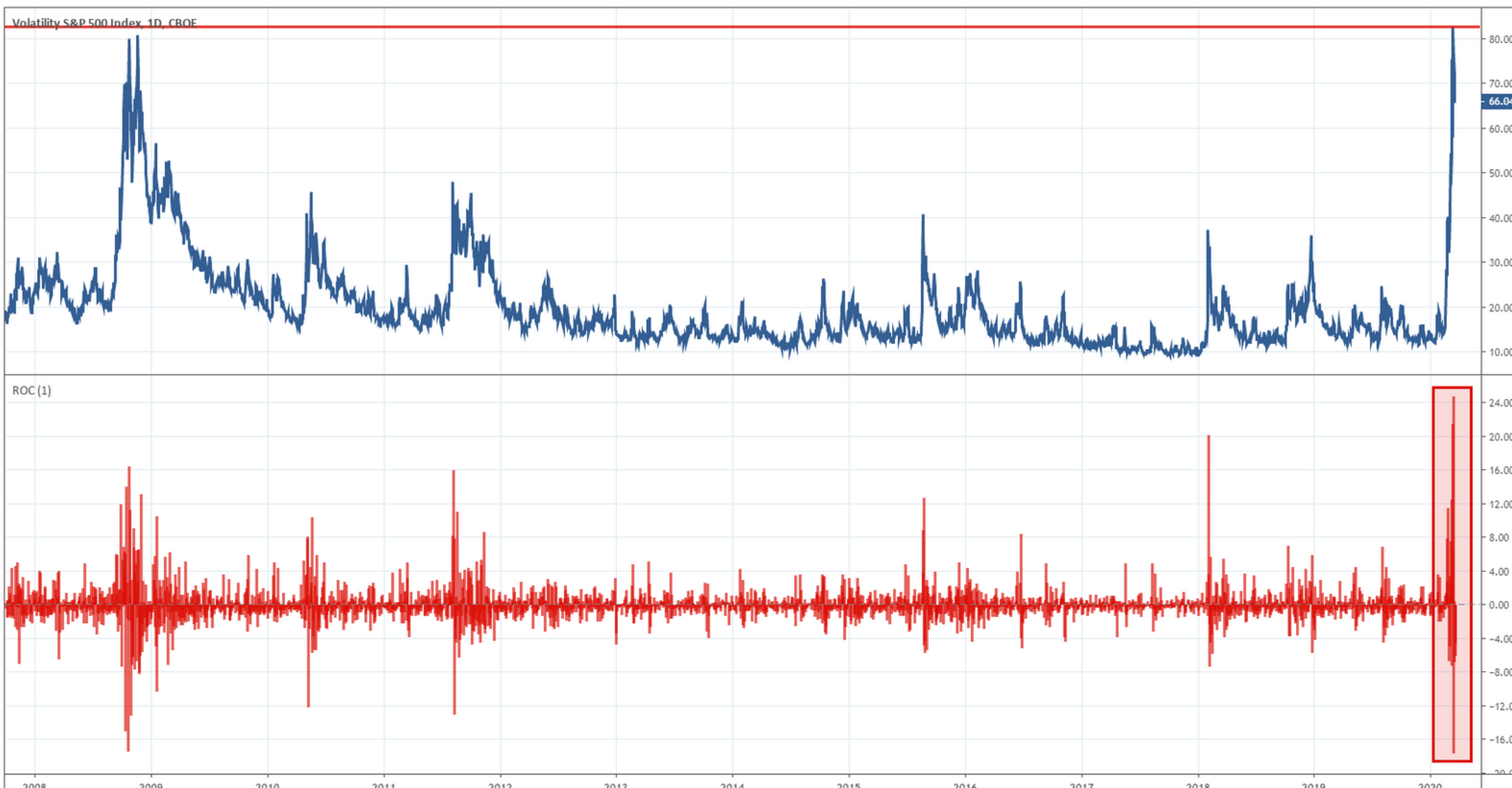
Under normal market conditions, a tick up in volatility in one asset class can have muted effects on others, highlighting the benefits of a diversified portfolio. But **when volatility blows out across multiple asset classes, the effects can be detrimental** as crowded strategies (i.e. risk parity) unwind positions and de-risk all at once. The VIX Index (aka the "Fear Gauge") closed at its **highest level on record** this past Monday (82.69), surpassing its previous high more than 11 years ago in the depths of the financial crisis. Investor fear is starting to hit extreme levels too, at least measured by the CNN Fear & Greed Index, which is hovering near its lowest level since December 2018.

VIX Index vs. Daily Change (Bottom Panel)



Data as of March 22nd, 2020
Source: TradingView, Cboe

Gold Sells Off Amid Move to Cash

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When investors are panic selling into cash, not even gold is insulated from liquidity-driven market corrections. The precious metal saw its worst weekly decline in more than eight years in early March and has failed to catch much of a bid since, despite rising fear and central bankers' latest tsunami of monetary stimulus. **The precious metal is not exempt from violent price fluctuations or liquidations in the short-term as we've seen the last few weeks.** During its latest pullback, we saw gold's price bounce off its 50-week moving average (~$1,460), a level it hasn't closed below since December 2018. Similarly, gold's rebound today pushed its price back above its 200-day moving average as the precious metal fights to maintain any upward momentum. Speculative positioning in gold futures has been exceedingly stretched with net longs hovering near cycle highs, partially explaining some of the forced selling as of late.

<u>Gold vs. Daily Moving Averages & 14-Day RSI (Bottom Panel)</u>

Data as of March 23rd, 2020

Source: TradingView

Gold vs. Fed Funds Futures

Global central banks are throwing everything they can at the market right now in an effort to stem the bleeding, though their efforts are largely falling on deaf ears. Again, when liquidity dries up, investors pivot to any asset they can offload without risking sizable slippage. Even the Fed's aggressive decisions to cut rates to zero and unveil "unlimited" QE have failed to send the precious metal higher. Part of it is a "buy the rumor, sell the news" scenario as the market had already begun pricing in another 100 bps of Fed rate cuts by year-end leading up to its official announcement. But until volatility subsides, gold may be caught in a range as investors continue moving to cash. However, at $1,550/oz, **the set up for gold is starting to warrant serious consideration,** especially as more details surrounding the massive fiscal stimulus plan take shape.

Gold vs. Fed Funds Futures (Dec. 2020)

Data as of March 23rd, 2020
Source: TradingView, CBOT, CME Group

Real Yields Spike

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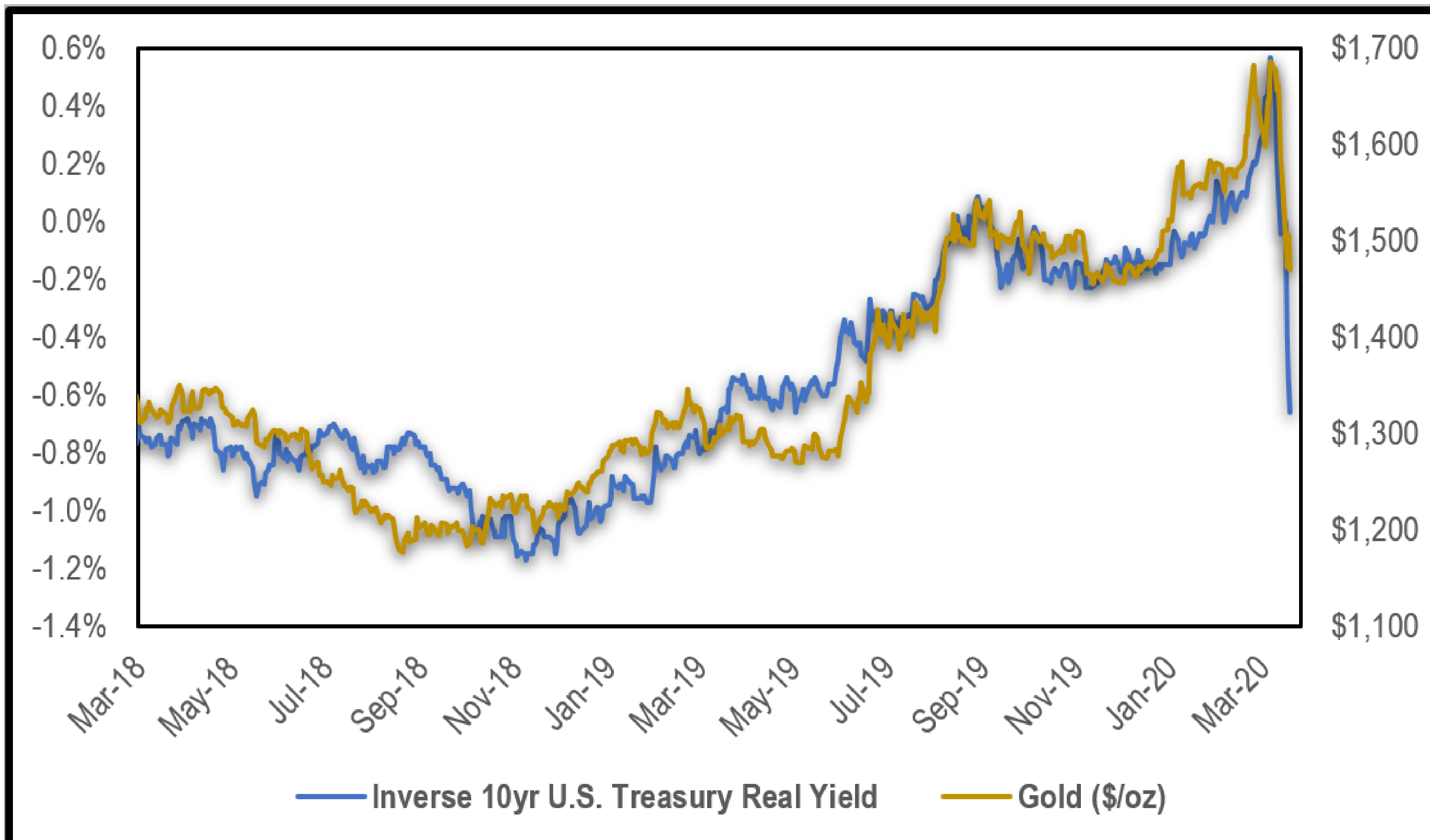
Investing is all about evaluating opportunity costs. When the expected return on government bonds is low, for example, the opportunity cost of holding a non-income producing asset like BTC or gold is greatly diminished. For much of the last 18 months, the general decline in real yields on long-dated Treasuries has coincided with higher gold prices, as one might expect. However, we've seen a **sizable collapse in inflation expectations over the last week,** which caused real yields to spike and gold to pullback more than 10% heading into the weekend. **The surge in demand for U.S. dollars also pushed the greenback to its highest level in more than three years,** adding further pressure to gold's price amid the latest bout of market volatility. The Fed's announcement this morning appears to have halted the dollar's advance, which has rallied its way to becoming one of the biggest risks to the global economy at the present moment.

Gold vs. Real Yield on 10-Year U.S. Treasuries (Inverse)



Data as of March 23rd, 2020
Source: FRED

Disclosures

DELPHI DIGITAL

85 Broad Street
New York, NY, 10004
www.delphidigital.io

team@delphidigital.io