Weekly Perspectives

---Monday, June 15, 2020

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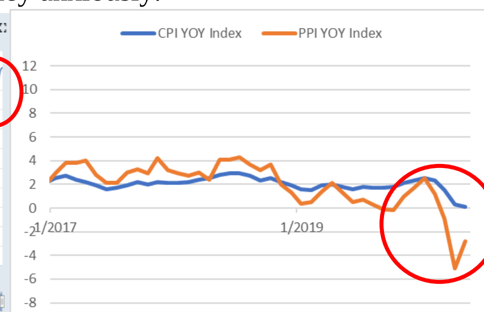
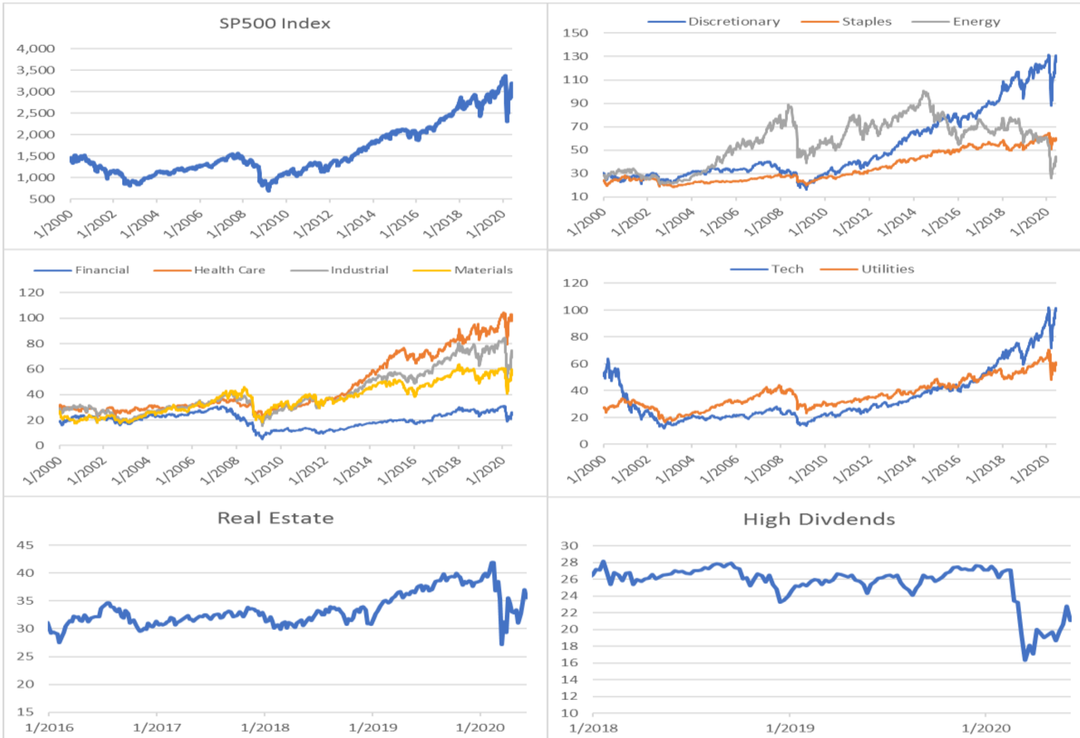
While US is passing the COVID19, economic rebound is still in question. Market sentiment recoveries and rebounds to new high since the “big virus drop” early March with almost no support from the fundamental side. It seems money circulation differentiates a lot when compared real economy and financial market. The relationship between inflation and M2 growth is broken.

- Fed is expanding balance sheet about $ 3T since March, and as the state is re-opening in Jun, what we expected to see a raise in PPI and CPI but get a drop instead.
- As Fed announcing purchase program early March, we see US M2 is spiking. Dollar is circulating into the financial system and support money circulation in real economic. However, the PPI and CPI still get a hit and continuing to drop in May. That tells us real economic is still facing a deflation as Fed is printing money anxiously.



- What could happen in the economy is that as Fed providing loan purchase and G-bond purchase, it circulates money into the system. But as the bank gets those money instead of lending it to corporate, it gets flooding into stock market. Or maybe the corporate who makes the new loan is putting its loan money into stock market. In the combination stock market rebounding quickly. The reason for the money flowing is simply by the risk aversion and lack of good potential investment for real economy. So as the lender gets money they go directly to stock market and start trading. This phenomenon is quiet similar to China’s housing market.



- As we can see from the above sector index overview, Staples/Financial/Utilities sectors stay relative strong since the market crash while Tech and Discretionary sectors rebound sharply after market is changing sentiments. As we also noticed, luxury selling is picking up a lot in China since May which is the only place shows a revenge consumption. This together is in line with US market as the COVID19 at large people non-discretionary consumption goes up and financial sector/Tech not affected much compared to other economic area. Right now, market still hold a negative view on real estate and high dividend sector.
- Fed is talking about YCC (Yield-Curve-Control) program instead of QE which aims at control a mid-term target rate and somehow some parts of the yield curve. As last year we seen a inverted yield curve in the market, a huge drop following. As the YCC control probably there will no longer an inverted yield curve. But if this program implemented, all curve trader will go out of business. And as the program pushing to start market will move sharply towards the target shape. This will of course free market nervous about inverted curve but also destroyed the alarming or signaling function of bond market. If in a middle term the curve aims at a low flat rate that probably will disappointed borrower to get loans since they will not be afraid to see increase in rates.