

March 22, 2020

# Perspectives

## *March Madness*



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The last two weeks have been surreal. In the 25 years we have been in the business, there has been nothing like this. We are sure many of you are feeling the same. At our core, we are optimists, but as our daily default we are more realists. The health crisis and markets will undoubtedly get worse before it gets better. It seems like the next two weeks will feel like two years. The private sector response coupled with the Federal Reserve and Treasury has been inspiring and historic. As it relates to Requisite Capital Management, we are business as usual. We are all healthy and we have a great, cloud-based technology platform that allows us to have the same interface remotely as we do in the office and we are available 24/7.

### **Where do Equities Bottom? We Will Know Only in Hindsight.**

Fundamentals and technicals take a backseat to emotions in times like these. From a technical perspective, 2350 on the S&P 500 touches the December 2018 lows. We breached that level last week. The next support level for the S&P 500 is ~2150, which would bring us back to 2015 levels. As unbelievable as these numbers seem, history tells us that we don't stay at bottoms very long. So, while we may trade through these important technical levels, sharp rallies can and do occur.

Currently, the only asset class investors want to own is U.S. Treasuries, as every other asset from investment grade municipal bonds to equities is being sold indiscriminately. This selling has and will create many opportunities. We do not share the view that the world is coming to an end. but for the time being, there are too many unknowns and it is highly likely markets will continue to have pressure to the downside. As H.P. Lovecraft so appropriately said, "The oldest and strongest emotion of mankind is fear, and the oldest and strongest kind of fear is fear of the unknown." The next few weeks might feel like a year, but they will pass.

2020 is setting up to be a year we would all rather forget. For many, sitting still will be the hardest of challenges. We do know that opportunities will present themselves, as sellers are abundant and buyers are scarce.

## Fixed Income Markets

While the volatility in the equity markets over the last two weeks has not been seen in almost 90 years, a similar amount of dislocation has been witnessed in the fixed income markets. Our belief is that when the fixed income markets stabilize, we will begin to see equity markets follow suit. The municipal bond market is a perfect illustration of how dislocated fixed income markets have become.

Fixed Income Rates (as of March 20, 2020)		
Type	Treasury Rates	AAA Municipal Rates
<b>Money Market</b>	<b>0.31%</b>	<b>4.50%</b>
1-year	0.15%	2.26%
2-year	0.37%	2.23%
5-year	0.52%	2.19%
10-year	0.92%	2.45%
30-year	1.57%	3.05%

Yes, this is correct. The one-day yield in municipal money markets on Friday was 4.5%! That is a taxable equivalent yield of over 7.5% assuming a 40% tax rate. The sleepy municipal market, which has only a few trades on slow days, experienced historical outflows of over \$12 billion last week. The prior record for weekly outflows was \$4.5 billion back in 2013 during the Taper Tantrum. When fear is at this extreme level and the only asset investors want to own are Treasuries, the price becomes completely disconnected with the actual future value. The Federal Reserve and Treasury are working at warp speed to inject as much liquidity as needed to address these dislocations.

## Volatility

Since 1928, two out of the ten worst one-day declines occurred this month. If there is any silver lining, historic volatility on the downside has typically been followed by historic days to the upside.

The S&P 500 is down -32% from its' highs in just 20 days. Not since the Crash of 1987, or the actual Great Depression have markets seen such a vicious sell-off in such a short amount of time. Let us be clear, we do not believe we are going into another depression, but more likely a sudden and sharp, short lived recession. The combination of a massive ramp up in supplies, testing and quarantining coupled with the historic fiscal stimulus that will most likely be announced tomorrow will create a safety net from this incredible economic shock.



## The Federal Reserve and the Treasury

Another level of dislocation is in the Treasury market. At times this week, the bid/ask spread between treasuries was .25 - .45%. This means that the bid (the price you sell a bond) and the ask (the price you buy a bond) was at times more than half of the yield of the bond itself.

The Federal Reserve and the Treasury are very aware of the historical dislocations and are implementing huge programs to add massive liquidity to the system to balance out the massive flight to Treasuries. We would expect that more programs will be announced over the coming days. Expect the Fed and the Treasury to continue to do whatever is necessary to inject enough liquidity in order to restore a sense of confidence, so the underbelly of the fixed income market is functioning properly. Notable moves over the past week are as follows:

### Sunday (3/15/2020)

- Emergency rate cut putting Fed Funds rate between 0-.25%.
- \$700 billion in US Government Asset Purchases, which is a quantitative easing program where the Federal Reserve buys Treasuries and mortgage backed securities.
- Federal Reserve encourages banks to borrow from the Fed using "the discount window." The discount window provides an important role in supporting the liquidity and stability of the banking system. The Fed reduced the interest rates banks must pay.
- Announced on Sunday, but beginning on March 26<sup>th</sup>, the reserve requirement ratios for banks will be 0%. This will help support bank lending to consumers and businesses.

### Tuesday morning (3/17/2020)

- New Commercial Paper Funding Facility (CPFF2020). Commercial paper is how many corporations finance short term obligations and is essential to the market. The Federal Reserve

Bank of NY now essentially acts as a backstop to ensure this important source of funding for corporations is functioning properly.

### **Tuesday afternoon (3/17/2020)**

- Primary Dealer Credit Facility (2020 version) – allows the 24 primary dealers to borrow from the Fed by pledging eligible collateral which includes everything from investment grade corporates and municipals to equity securities.

### **Friday morning (3/20/2020)**

- The Money Market Fund Liquidity Facility was expanded to include money market eligible municipal debt.

## **The Economy**

The economic data that is going to be coming out over the foreseeable future will be awful. The surge in jobless claims will be historic and the business closures will be painful. Our first real data point on unemployment claims will be released on March 26<sup>th</sup>. It is being estimated that between 1.3 million and 1.5 million jobless claims will be filed in six days<sup>1</sup>. The depth and severity of the recession will depend on many variables. As investors, we want to prepare clients for the worsening of data, but what we know from history is the stock market will bottom well before the economy does. We are beginning to see green shoots from U.S. companies operating in China:

- On March 13, Apple reported that they have opened all 42 of their stores in China
- On March 18, Starbucks, who operate over 4200 stores in China, said 90% of its stores in China are now open and the board added as many as 40million shares to the buyback plan.

**The tests are coming... thanks to the private sector!** The government has clearly had multiple failures in getting tests out to the masses. What's clear is that once this virus passes, the crippling red tape within the FDA and CDC must change. But alas, the private sector is coming to the rescue. The U.S. must be able to test the masses, so that we can not only treat the ill, but be able to quarantine those who have the virus but are asymptomatic. That allows everyone else to get back to work. We aren't there yet, but with private sector testing ramping up, we are finally on the right path:

- Abbott Labs received emergency use authorization from the FDA and [announced this week they will ramp up production to one million tests by the end of March](#). They have already shipped 150,000 tests to existing hospitals and laboratories.
- Roche [received approval to start shipping their test kits](#), with 400,000 expected to arrive this week.
- On Monday, Austin based *everywell* announced that this Monday [they will start offering home-test kits for Covid-19 testing](#). These will undoubtedly be in high demand.

## What are we Paying Attention to?

Tonight, [60 Minutes will do a deep dive into the various antivirals and vaccines](#) and the incredible speed scientists globally are working to find solutions.

We are staying current on Covid-19 using social media.

Although social media has given us the benefit of being able to connect with our friends, old and new, the negative side of social media and the 24/7 internet is that everything is amplified. Every mistake, every theory (real or fake), every thought one has, can be instantly "tweeted" for all of us to pontificate. As the literal health of our nation is at stake, below are two Twitter accounts we consistently monitor to understand the facts, not the fiction, surrounding Covid-19:

Scott Gottlieb, the former Head of the FDA ([@ScottGottliebMD](#))

The Centers for Disease Control & Prevention ([@CDCgov](#))

Locally, we urge our clients who are on Twitter to follow your state politicians and health care sites as they have fact-based information on what is happening. For example, in Texas we are following:

Greg Abbot, Governor of Texas ([@GovAbott](#))

Eric Johnson, Mayor of Dallas ([@DallasMayor](#))

Houston Health Department ([@HoustonHealth](#))

## Conclusion

Tomorrow, the markets are expecting a large rescue package to come from Washington D.C.. Politicians are expected to vote on this tomorrow morning. We will be paying close attention to the fixed income markets and looking for signs of stability from the various Federal Reserve programs. We expect this stability to lead to a decline in stock market volatility, which will ultimately result in a stabilization of the equity markets.

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