GUGGENHEIM

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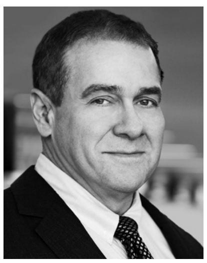
Global CIO Outlook
Note to Clients: Markets Infected by Coronavirus



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The impact of the coronavirus has made for a crazy couple of weeks in the financial markets. Now spreading beyond Italy into other parts of Europe, it is on the brink of a pandemic and investors, fearing a sharp slowdown in global growth, have reacted by taking out support for yields for the long bond and the 10-year Treasury note. Bonds are comfortably below 2 percent and the 10-year Treasury yield is hovering around 1.3 percent. Unlikely as it may seem, technical analysis now indicates a target yield on the 30-year bond at 1 percent and the 10-year note at 0.25 percent. Stocks are nearing correction territory, with more downside likely.

At the same time that long Treasury yields are making new historic lows, credit spreads, while widening, remain relatively tight. This does not make any sense given the fundamental backdrop which indicate that defaults will rise significantly, particularly in energy, airlines, retailing, and hospitality. Nevertheless, central bank liquidity continues to drive flows into bonds at a record pace. These flows are keeping spreads tight and, until there is an interruption of the inflows, credit spreads will be contained.

We are trying to buy as many high quality longer-duration assets as possible at reasonable yields to help lengthen duration in the face of potentially lower rates, but 3 percent is becoming a difficult yield to reach. We are selectively adding to BB credits which we think are “money good” to certain accounts to enhance yield.

All in all, these are “interesting times” as the old Chinese curse goes. Going into February, my overriding concern was that the Federal Reserve (Fed), by purchasing $60 billion in Treasury bills per month, was lifting asset values across the board in the fourth quarter and into the first. This form of quantitative easing was causing what I called the everything bubble, because virtually every sector was up over the past year.

Now apparently the everything bubble for risk assets is in danger of deflating. The coronavirus is showing us the unpredictable path that an exogenous force can play in interrupting an economy that is already exhibiting many late-cycle symptoms. And it is far from over. The Center for Disease Control (CDC) has been firm in its warnings, as Dr. Nancy Messonnier of the CDC urged, "We are asking the American public to prepare for the expectation that this might be bad."

We have reached the tipping point. Either the epidemic will be quickly contained or the world will soon slip into pandemic. I'm not an epidemiologist so I will leave the semantics to the medical experts, but of this I am certain: From a U.S. perspective if our neighbors are infected, it will be an epidemic. If infections begin rapid transmission in the U.S., we will call this a pandemic.

For the moment we have found support in the S&P 500 around 3,000 and the decline in the 10-year Treasury yield has stopped out at around 1.25 percent. For the time being, I would expect retracing in both markets as stocks and bonds stabilize or even rise in price.

In the coming days, market prices will be the tell as to how the disease progresses. For the moment, panic is high. To be clear, I am not saying the worst is over; but, rather, it is time to take a break and assess the next moves.

Eventually, we may have an opportunity to add more risk assets to our client portfolios as economic growth slows around the world and corporate borrowers default. Certainly, the chances of recession are rising rapidly for which we are well positioned. As Solomon said, "The wise man sees danger ahead and prepares himself." There is certainly possible danger ahead and we will be looking for its cousin "opportunity" if this turns into a crisis. It may already be one.