KF Spotlight : Unprecedented, Shocked and Anxious

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After a double digit CAGR over the past decade, the start of this decade proved to be an ominous one as both the Dow Jones Industrial Average (DJIA) and S&P 500 index (S&P) tumbled more than 20% within the first quarter of 2020. Nasdaq 100 also shed 14.2% for Q1 2020.

Dow Jones fell 23.3% quarter-on-quarter, its biggest quarterly decline since Q4 1987. Meanwhile S&P 500 plunged 20%, the largest quarterly decline since Q4 2008.

Despite starting the year in a bullish tone following the conclusion of Phase I of the US-China trade agreement, 50-year low unemployment rate, robust economic growth and dovish monetary policies from the US Federal Reserve, the market took a wild swing as the perfect cocktail mix of plunge in crude oil prices, rising concern of the COVID-19 pandemic, fear over supply chain disruption and all-time high unemployment rate took over and dominated market sentiment.

With lockdowns, closure of businesses and rapid increase in COVID-19 cases in US, earnings in Q1 and Q2 is forecasted to take a massive hit as businesses struggle to cope with these challenges. Despite the USD2 trillion stimulus package and quantitative easing policies from the US Federal Reserve, we expect more downside potential in the short-term and high volatility continues to be a recurring theme in the market. White House officials also projected between 100,000 and 240,000 deaths in the US with coronavirus fatalities peaking over the first two weeks of April.

Amid the negative factors, we do see the fiscal and monetary policies to fuel some optimism in the market and provide some support. Based on Fibonacci retracement, we might see support for Dow at the 18,000-level, while S&P 500 might see some support at 2,000 points and Nasdaq 100 at 5,500 points within Q2 2020.

	Index Price	March Monthly % Change	Q1 2020 % Change
Dow Jones	**21,917.16**	**-13.74%**	**-23.20%**
S&P 500	**2,584.59**	**-12.51%**	**-20.00%**
Nasdaq 100	**7,700.10**	**-10.12%**	**-14.18%**

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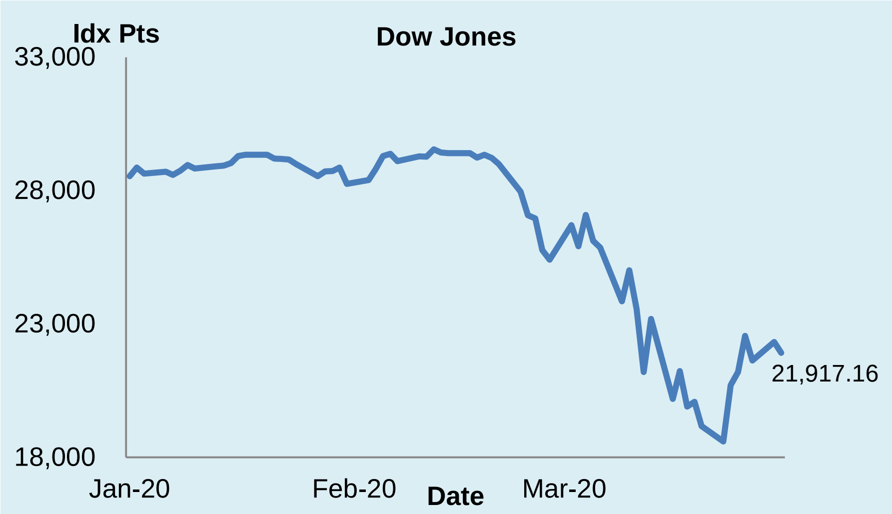
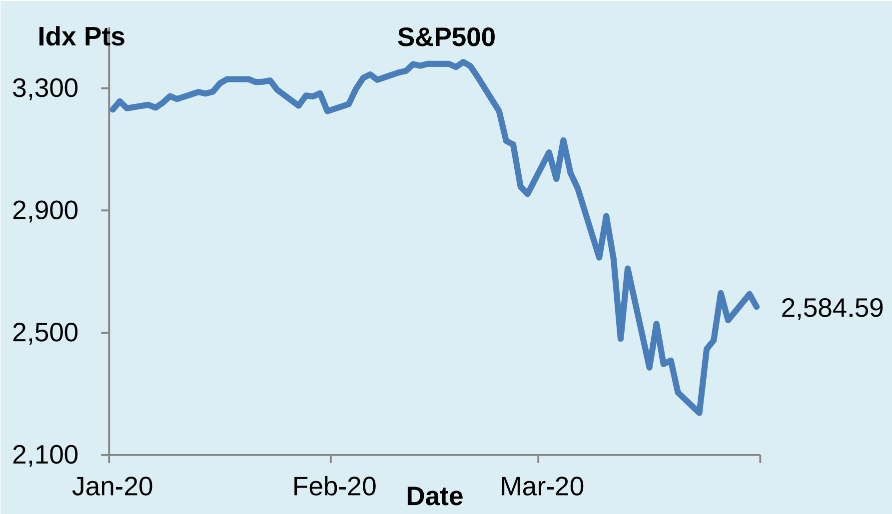
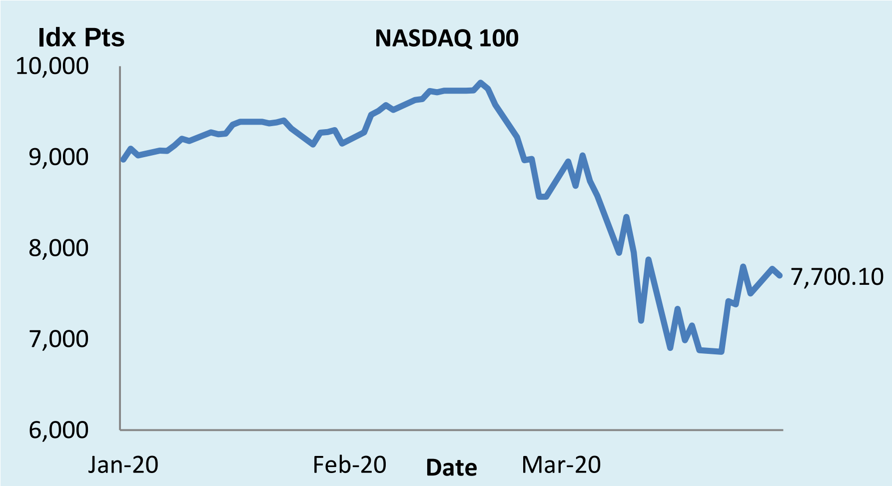
US Indices Performance For Q1 2020



Last Price	**: 21,917.16**
High	**: 29,551.42**
Low	**: 18,591.93**
Range	**: 10,959.49**
30 – day Volatility	**: 90.52**



Last Price	**: 2,584.59**
High	**: 3,386.15**
Low	**: 2,237.40**
Range	**: 1,148.75**
30 – day Volatility	**: 84.33**



Last Price	**: 2,584.59**
High	**: 9,817.18**
Low	**: 6,860.67**
Range	**: 2,956.51**
30 – day Volatility	**: 82.79**

Source: Bloomberg

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What Happened to the US Stock Market in Q1 2020?

❖ January 2020

S&P 500 (-0.99%), Dow Jones (-2.12%)

+ The bullish sentiment and price action from 2019 which was carried over into the first two weeks of 2020.
+ The signing of the phase one US-China trade deal on 15 January.
+ The positive US Q4 2019 GDP numbers was in line with analysts' expectations, growing at 2.1% quarter-on-quarter

- Mounting fears over the spread of coronavirus in China region caused investor concerns over disrupted supply chains and weakened demand.

❖ February 2020

S&P 500 (-9.07%), Dow Jones (-10.53%)

+ Robust economic data where the US unemployment data remained near a 50-year low.

- Rising number of Coronavirus cases globally including the U.S, has triggered on of the sharpest US stock market sell-offs in history due to persistent concern over global supply disruption and lower economic growth

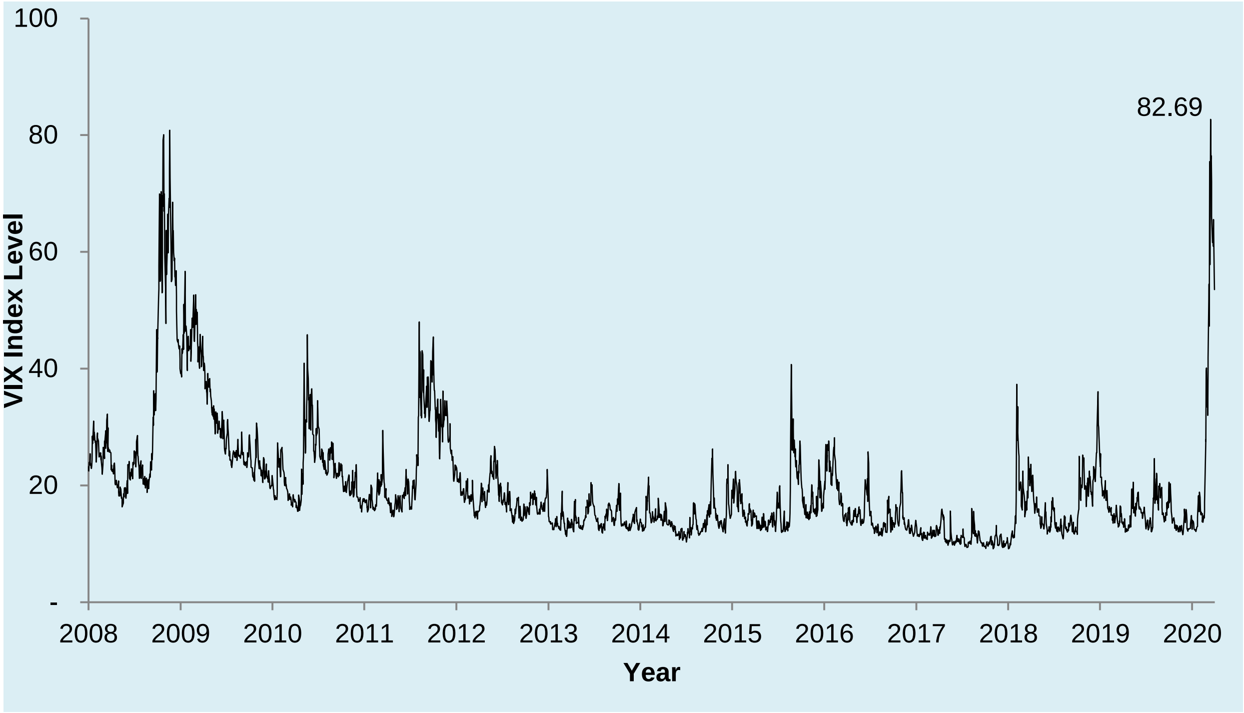
❖ March 2020 S&P 500 (-27.60%), Dow Jones (-30.38%)

- The Federal Reserve slashed interest rates by half a percentage point in an emergency rate cut and committed to make unlimited bond purchases to prevent an economic depression.
- The US government announced a US$2 trillion stimulus package, the biggest ever in U.S history.

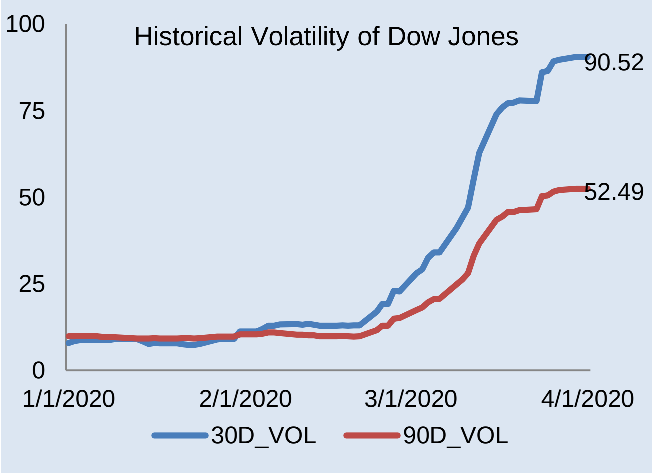
- The rapid rise in the number of Coronavirus cases in US caused a widespread concern and World Health Organisation (WHO) declared it a worldwide pandemic on 11 March.
- Negotiations between OPEC and Russia ended without an agreement, sending crude oil prices plunging by more than 60% in the quarter.
- Initial jobless claims data hit a record high of 3.28 million in the week ended March 21, dwarfing all the previous highs since such data was recorded in 1967.

How Volatile is the Stock Market at the Moment?

VIX, or better known as CBOE Volatility Index is a real time market index that measures the stock market's expectation of volatility implied by S&P 500 index. The low readings on the index indicate calm, while higher readings typically represent fear. Based on the chart below, the VIX readings have touched the 80 level, which signified the rising level of fears over market uncertainty. The last time VIX readings reached near 80 level was in 2008, in relation to the Lehman Brothers' bankruptcy.



On 16 March 2020, the VIX index reached 82.69, setting a new all-time high and surpassing the peak of 80.64 seen in 2008's Global Financial Crisis. Since then, the indicator has maintained above 50 level, indicating the high level of fear and anxiety among investors.



Based on historical volatility of Dow Jones, the moving 30-day volatility has also shot up 8 at the start of the year to 90.5 at the end of the quarter, signaling the increasing price swings since end-February. The longer-term 90-day volatility has also spiked to 52.5 at the end of March.

For reference, the previous 30-day volatility record high was 77.01 on 14 November 2008.

Source: Bloomberg

What are the Measures taken by US Government So Far?

Monetary Measure

The central bank of United States, or better known as Federal Reserve (Fed), has already adopted several monetary measures to combat the possible economic downturn.

- The Fed on March 23 has launched an unlimited quantitative easing (QE) programme that would purchase at least $500 billion of Treasuries securities and at least $200 billion of mortgage-backed securities in order to support the financial market without limit.
- The idea, which was used before in 2008, is to increase the money supply and eventually keeps the value of US dollar low which makes the stock markets more attractive to foreign investors.
- Earlier, the Fed had already trimmed the interest rates by 50 basis points on March 3 where many considered it as emergency rate cut to support the loan market.

Fiscal Measure

The US government announced a US$2 trillion stimulus package to rescue the economy with some of the details are as follows :

- Direct cash assistance to single, couples and parents of children under age 17 with adjusted gross income below $75,000.
- Suspension of student loan payments without penalty and accruing interest for at least 60 days.
- An extra $600 a week to the unemployed citizens for 4 months on top of their state benefits
- $500 billion lending program by US Treasury Department that consists loans, loan guarantees and investments to businesses, states and municipalities.
- Provision about $117 billion to hospitals for reimbursement in expenses and lost revenues to the pandemic.
- Provision of $450 million for the Emergency Food Assistance Programme

Source : CNN and CNBC

Outlook for Q2 2020

The outlook remains bleak in the second quarter of 2020 as the concerns from Q1 continue to persist. Such factors include:

1) Bearish Undertones Over Crude Oil Prices

Crude oil prices have fallen more than 60% since the start of the decade and WTI crude price is trading around US$20 a barrel handle. On the supply side, Russia has objected to further oil production cuts and Saudi Arabia had responded by offering discounts on its oil and pledged to increase its production in April. Meanwhile, demand for crude is expected to dwindle given the current COVID-19 situation that had grounded many planes globally. This impact had led both OPEC and US Energy Information Administration to slash their demand outlook for the year. However, things could get better should the nations involved eventually put their differences aside and come to an agreement to cut oil production.

2) COVID-19 Cases Continue To Be On The Rise In US And Globally

With the first human trial for a potential vaccine still at least 12 months away according to the US and global cases continue to rise, further lockdowns and disruption to supply chains will have a massive impact on global economies, with several nations expecting to enter recession. US has surpassed all nations to have the most cases at this point of writing and the White House had predicted that US might have between 100,000 and 240,000 cases by mid-April.

3) Concerns Over Economic Growth

As more flights continued to be grounded, businesses continue to be closed and production decline in manufacturing plants, the economy is bound to get a huge hit amid all these. Granted, the US Federal Reserve and US government had introduced record-breaking monetary and fiscal stimulus packages, it remains to be seen whether this is sufficient to weather this perfect storm.

Meanwhile, the International Monetary Fund (IMF) chief also expressed a deep concern about the negative outlook for global growth in 2020. Instead of a GDP growth, some analysts are now forecasting GDP contraction. The Conference Board in its latest update stated that “the US economy will see a GDP contraction ranging between 1.6% and 6% for 2020, with odds quickly moving toward the worse scenario.”

4) Unemployment Rate And Jobless Claims expected To Soar

After skyrocketing to a record breaking 3.28 million jobless claims on March 21 and another record breaking 6.6. million claims on the week ended March 28, economists are now expecting the worst after roughly 10 million Americans filed for unemployment benefits within 2 weeks. To put into context 9 million Americans filed for unemployment benefits during the 2008 Global Financial Crisis. Some analysts are predicting unemployment rate to soar as high as 15%. Millions of Americans have no other choice but to file for unemployment benefits and that means the economy is not just staring down at the abyss, it has fallen off the cliff and peering down into the depths of recession.

5) US- China Trade Agreement In Limbo?

After much fanfare and optimism following the signing of the Phase One of the US China trade agreement in January this year, Phase Two is now shrouded with uncertainty as the economic climate has shifted and global supply chains are severely affected in the short period of the past two months. In Q1 2020, efforts to contain COVID-19 had pummelled the Chinese economy with a record low in February’s manufacturing PMI while production has been slow to resume as travel restrictions hinder workers’ return. We are expecting the same conditions to play out in the US and other nations.

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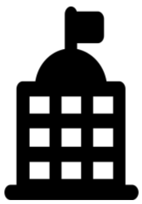
On Emergency Rate Cut : A Timeline of Last Emergency Rate Cuts

On March 3, the Fed has lowered the interest rates by 50 basis points, which according to many analysts, was unusual compared to recent history as it occurred against the backdrop of a strong US stock market. Here, we examine the past 6 emergency rate cuts that occurred in the last two decades in US history and the events that sparked the move.

January 2001

- Size of Cut : 50 basis point
- Reason for cut : The dot com bubble leading equities into a bear market

April 2001



- Size of Cut : 50 basis point
- Reason for cut : The Fed cut rates to avert a recession

September 2001

- Size of Cut : 50 basis point
- Reason for cut : The terrorist attacks of Sept 11, 2001

August 2007

- Size of Cut : 50 basis point
- Reason for cut : The subprime mortgage crisis

January 2008

- Size of Cut : 75 basis point
- Reason for cut : Stock market crash

October 2008

- Size of Cut : 50 basis point
- Reason for cut : The collapse of Lehman Brothers

Source : Business Insider

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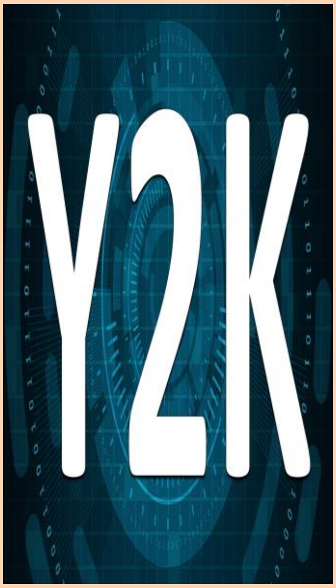
History of Recessions in the United States

Recession, by textbook definition, can be defined as a drop in Gross Domestic Product (GDP) for at least two successive quarters. As the largest economy in the world, a recession in United States of America will obviously impacted the whole world. Here, we examine some of the largest recessions for the past three (3) decades in the history of the United State.

1 The Gulf War Recession (July 1990 – March 1991)

- The Gulf War started on August 2,1990 when the forces of Saddam Hussein invaded oil-rich Kuwait.
- In response, the United States and other countries launched military operations known as Operation Desert Shield and Operation Desert Storm.
- As one of the largest oil reserves in the world, the war in that region has caused the crude oil market to slump as much as 30%
- The recession occurred afterwards and ran for nine months where GDP growth was -3.60% in Q4 1990 and -1.9% in Q1 1991.

2 The Dotcom Bubble and 9/11 Recession (March 2001 – November 2001)



- Early 2000 marked the collapse of the Internet companies in US history, or better known as the Dotcom bubble, where the shares of publicly traded Internet companies in US were plunged 75% from its 52 week high due to Y2K fear.
- The fear began at the start of the year 2000 when many people were concerns that the rollover to 2000 might cause computer systems to fail globally as many computer codes were set as two digits, for example "99", and the rollover to "00" might cause some failures.
- The scare had led to the declining trend in computer and software sales and subsequently brought many of the dot com companies to bankrupt.
- As a result, the economy contracted in the first quarter of 2000 at -1.1% but managed to bounce back to 2.1% in the second quarter.
- However, the 9/11 attacks had worsened the situation as the attacks had made the economy contract by 1.7% in the third quarter.

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3 The Global Financial Crisis of 2008 (October 2008 – September 2009)

- According to many analysts, the Global Financial Crisis in 2008 was the worst financial crisis in the history of United States since the 1929 Depression.
- The recession, which was triggered by the subprime mortgage crisis, can be traced back to 2007 when banks sold too many mortgages to feed the demand for mortgage-backed securities.
- When home prices fell, the defaults were triggered and the risk spread into mutual funds, pension funds and some big corporation like Lehman Brothers.
- Eventually, the crisis reached the entire economy by the third quarter of 2008 when GDP fell by 0.3%.
- By Q4 2008, GDP was -8.40% which was worse than any other recession since the Great Depression.
- The economic stimulus package announced by the former US President Barack Obama had finally turned the US GDP into positive in Q3 2009 to end the recession.

Source : The Balance

Is US on the Brink of Recession this year?

- For the first time in its history, United States of America started and ended an entire decade without entering any recession in which according to the National Bureau of Economic Research (NBER) was the longest time period in the country's history.
- Some of the analyst cited that one reason for this economic expansion is because of the adeptness of US policymakers, through its fiscal and monetary policy, in responding to the economic changes.
- In fact, the country's economy grew by 2.30% for the full year of 2019 despite several setbacks in global development.
- However, this year might be a different narrative for the world largest economies amid the unprecedented COVID-19 outbreak.
- Although the official economic figures for the first quarter of this year are yet to be released, some signs of economic downturn has already appeared.
- For example, based on data from US Labor Department on March 26, the number of Americans filing for unemployment benefits had surged to a record 3.28 million in the week ended March 21 as many businesses shuttered and laid off workers.
- In addition, the Fed Chairman Jerome Powell has also said that the country "may well be in recession" in a television interview on NBC's "Today Show".

Source : CNBC and The Edge Market

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Hedging Opportunities on CME Group

Product	E-Mini S&P 500	Micro E-Mini S&P 500	E-Mini Dow	Micro E-Mini Dow
Exchange	CME	CME	CBOT	CBOT
Product Symbol	ES	MES	YM	MYM
Contract Multiplier	$50 x S&P 500 Index	$5 x S&P 500 Index	$5 x DJIA	$0.50 x DJIA
Minimum Price Fluctuation	USD 0.25	USD 0.25	USD 1.00	USD 1.00
Value Per Tick	USD 12.50	USD 1.25	$ 5.00	$ 0.50
Settlement	Cash Settled	Cash Settled	Cash Settled	Cash Settled
Trading Hours (Malaysian Time)	Monday through Saturday : 7.00 am – 6.00 am (Next Day) (Non-Daylight Savings Time)			

Source : CME Group

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