



30 March 2020

## Two trillion to counter the effects of Covid-19 in the US

**Drastic change in health strategy. Massive backing by the Fed. Historic tax package. Slump in growth in Q2. The presidency to the Democrats? Rebound in equities.**

### Key points

- Trump capitulates in the face of the magnitude of the health crisis in the US
- The US is the new epicentre of the crisis
- Alarmist estimates of up to 200,000 deaths
- Is Trump losing the 2020 presidential election?
- 2 trillion dollars to counter the effects of Covid-19
- Key rates at zero
- Increase in government deficit of close to 20% in 2020
- Has the Fed exhausted its creativity?
- Sharp contraction in GDP in Q2
- Possible rebound in Q3
- USD interest rates close to zero
- What prospects for equity markets?

### Trump capitulates in the face of the magnitude of the health crisis in the US

The US government undoubtedly underestimated the risks relating to Covid-19 for a little too long. Indeed, President Trump played a major role in the disastrous management of the health crisis in the US by initially refusing to recognise how dangerous the new virus actually was for the US population. After clearly seeking to minimise the effects of Covid-19 by likening the virus to a simple flu that would disappear of its own accord as the weather improved, the US President may have wasted valuable time in terms of enabling the country's health authorities to warn the population and the US healthcare system to prepare to more successfully deal with a crisis similar to what Europe was experiencing.

The realisation finally came after financial markets raised the alarm with the fastest bear market decline in international history. Deeming that the US was somehow immune to Covid-19, the President only belatedly and reluctantly triggered measures similar to those taken by other developed countries, quickly emphasising that these confinement measures would not last and arguing that the world's leading power would not choose a cure worse than the disease. Trump does not want to run the risk of seeing US growth hampered by the damaging effects of health measures that are essential to protect the population, but he has run out of options. The number of Covid-19 cases is surging very quickly, as is the number of deaths, which in a few days have placed the US at the centre of the map of countries most affected by the virus.

As we had already mentioned in previous analyses, the US will not handle this health crisis any better than other countries, despite the expertise and excellence of its research teams and multinational corporations at the cutting edge of medical innovation.

Indeed, the US's current healthcare system is not ready to withstand the surge of patients that will soon overwhelm its hospitals. In terms of number of beds per 1,000 inhabitants, the US actually has the worst ratio in the G7, with only 2 beds in comparison with 8 for Japan for example. Nevertheless, the healthcare system will be able to rely on the authorities' capacity to swiftly implement alternative solutions. The world was surprised to see China build a 1,000-bed hospital in the city of Wuhan over just a few days to cope with the influx of patients, and the arrival of a 1,000-bed hospital ship in New York is an example of the solutions that may be provided in the next few weeks to the increase in Covid-19 cases in the US.

Despite the US President's promises to reopen the country very soon, it is essential to remain cautious and objective about the future development of the epidemic

and the effectiveness of the measures taken before considering a return to normal for the country and the US economy.

## Is Trump losing the 2020 presidential election?

The US President is certainly risking his re-election at this very moment. At the start of the year, we had mentioned that risks in 2020 for financial markets with clearly excessive valuations seemed to us to be less related to the issue of the trade war, which had been a major factor of uncertainty in 2019, than to new factors, especially chances of seeing the Democrats win the presidential elections in November. The Democratic nomination has not yet been awarded to Joe Biden, although he is likely to be designated soon. After fearing an excessively left-wing nomination with candidates such as Bernie Sanders and Elizabeth Warren, the Democrats now have more chances of winning the presidential election come November 2020 than before the primary.

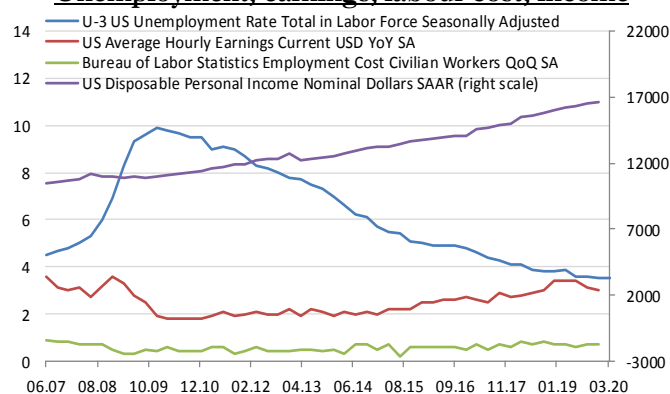
The Covid-19 crisis is likely to last several months in the US and will certainly be at the heart of voters' concerns during the campaign. At the time of writing, the upward curve of Covid-19 cases in the US is the steepest among industrialised countries. The epidemic is thus spreading more rapidly after 25 days than it did in China, Italy and Spain. More than 40% of the US's population usually say that they will not see a doctor in case of illness for fear of not being able to bear the costs. Should this fear persist during the development phase of the epidemic, then it will likely constitute an aggravating factor for the spread of the virus and its impact. Some alarmist predictions suggest that the potential number of deaths in the US might reach 200,000 people, i.e. five times the number of officially reported deaths to this day, which amount to 40,000 for approximately 800,000 confirmed coronavirus cases.

The US President has not yet been directly blamed for his lightweight management of the health crisis, but once the situation is under control, the presidential campaign will resume and will undoubtedly be greatly influenced by this unprecedented crisis. Trump will likely appear as a man who did not take the US population's health seriously by not heeding the warnings and advice of the scientific community and public health experts. He is likely to bear the consequences of his blatant lack of empathy for the population, despite a 2 trillion dollar support plan, which he did actually support.

## Two trillion dollars to counter the effects of Covid-19

The Senate and House of Representatives successively voted on a fiscal package without precedent in the US of 2 trillion dollars a few days before the end of March. In a nutshell, the plan includes five main types of support. Approximately 500 billion will be provided as loans to the country's main industries, including USD 30 billion to airline companies and 20 billion to companies considered as vital to maintaining the security of the country. A little under USD 370 billion will be loaned to small and medium-sized enterprises, 150 billion are earmarked for local governments and US states and 130 billion will help support hospitals. Direct payments of USD 1,200 will be granted to individuals earning less than USD 75,000 per year, representing approximately USD 250 billion. Finally, unemployment benefits will be increased to a maximum indemnity of USD 600 per week, just as jobless claims exploded in one week from 282,000 (19 March) to 3,283,000 (21 March).

### Unemployment, earnings, labour cost, income



Sources: Bloomberg, BBGI Group S.A

Financial markets had been waiting for this unprecedented fiscal package for a few days, in the hopes that it would put paid to the downwards spiral that had already led to US shares losing more than 30% in total market capitalisation.

The market rally that occurred in the following days was indeed driven by this fiscal stimulus and by the Fed's previously announced actions. However, let us not forget that this will have an impact on the US public deficit, which may well explode to reach close to 20% of GDP!

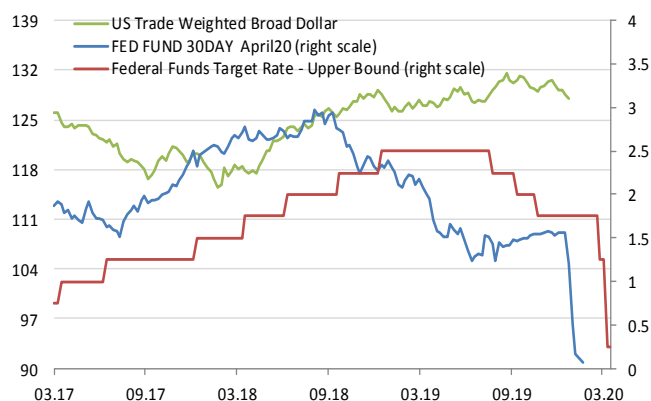
## Has the Fed exhausted its creativity?

So far this year, the US Federal Reserve has lowered its key rates to zero and resumed its public debt purchases. In order to counter the threat of production and consumption collapsing in the US due to the Covid-19 epidemic, the Fed has struck very hard by lowering its key rates to zero and announcing a new bond purchase

programme estimated at approximately USD 700 billion. The Fed Chair has once again asserted that the institution will use any tool available to support the flow of credit to households and companies, which is what it did when it announced it had taken new extraordinary measures to fight the effects of the coronavirus by creating a new mechanism meant to provide more direct support to households and companies. Indeed, the Fed has created a new credit facility called PDCF for Primary Dealer Credit Facility destined to the banks that are usually in charge of distributing US government bonds. The aim of this support programme is to enable intermediaries to loan funds more directly to those who need it because of Covid-19.

The Federal Reserve can now also count on the support plan adopted by the Senate and the House of Representatives to reinforce the expected positive effects of its new expansionist policy. In this context, the Fed will be able to increase its asset purchases by several additional trillion dollars.

#### **Fed funds, key rates & trade-weighted dollar**



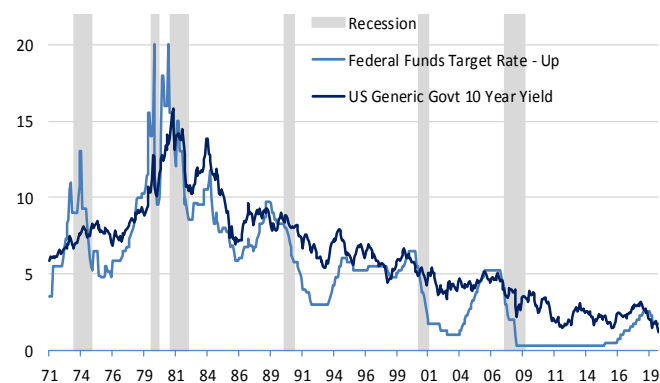
Sources: Bloomberg, BBGI Group S.A

### **Sharp contraction in GDP in Q2**

The latest GDP figures for Q4 2019 published on 26 March pointed to a growth rate of +2.1%, which only a few weeks ago seemed likely to continue in 2020. It has now become particularly difficult, however, to estimate the impact on growth in Q1 of the Covid-19 outbreak and the partial or more comprehensive confinement measures that have been taken by the various US states. In the last few days, leading indicators have also shown a breakdown in confidence and outlook, especially in the services sector. The manufacturing PMI dropped from 50.7 to 49.2 in March, suggesting better resistance than the services PMI, which dropped from 49.4 to 39.1 over the same period. The shock of Covid-19 is shaking up the American economy, which had remained relatively immune in Q1. A sharp contraction of economic activity is thus very likely in Q2, whose scope will be difficult to assess before the summer.

The nature of the shock is so extraordinary that an assessment of the impact in Q2 is less essential in our minds for the management of risks and opportunities in terms of investment than the determination of recovery probabilities in H2 for the world's largest economy.

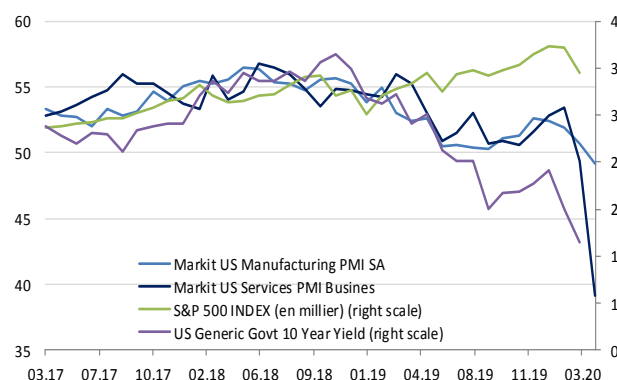
#### **US recessions, long-term rates & Fed funds**



Sources: Bloomberg, BBGI Group S.A

Developments in the health situation in the US will certainly be different than those observed in China and Europe. As it stands, it is particularly difficult to predict at what pace the economy will recover in the US, as the only example of recovery available at the moment is the Chinese market, for which we have only limited reliable data. Nevertheless, if China's example can serve to estimate the time required for the US economy to recover, it is possible that a gradual return to normal activity should not be expected before the summer. The synchronisation of economic cycles will likely be more favourable to the US, which could then already count on a credible recovery in Asia and Europe at the end of Q2 2020.

#### **Long-term rates, PMI & S&P 500**



Sources: Bloomberg, BBGI Group S.A

## USD interest rates close to zero

At the start of the year, bond markets quickly integrated the economic impact that a global spread of the Covid-19 epidemic in China could have on global growth as well as US growth, unlike equity markets, which were very slow to react to the epidemic turning into a pandemic. The collapse in ten-year Treasury yields from 2% in December 2019 to 0.31% at their lowest point on 9 March was historic and came shortly before the Fed's decision on 15 March to lower its key rates to their lowest historic level.

The drop in financial markets, which accelerated in the first two weeks of March, had a worrying negative impact on the credit market, which saw a sharp increase in interest rates, including on US Treasuries, whose yield jumped from 0.31% to 1.25% in seven days. The Fed had to shore up liquidity in the short-term lending market and resume its asset purchase programme in a context shaken by risks of malfunction of a financial system disrupted by the forced sales of all sorts of assets, including those usually considered safe like government bonds and gold. The government bond purchase programme is likely to maintain long-term government rates at historic levels until prospects of emerging from the health crisis and of a significant economic recovery materialise.

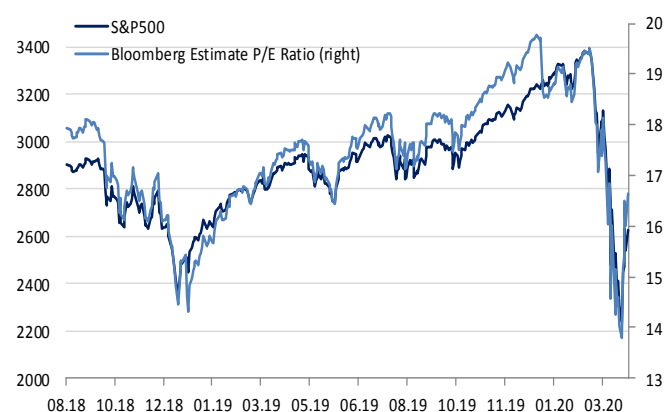
## What prospects for equity markets?

We had mentioned before the collapse in the last few weeks that equity markets in the US were overvalued and that we believed that the complacency characterising the last phase in price increases in January 2020 in particular, at a time when China was suffering heavily from the coronavirus, was a sign of blatant irrationality from investors in the face of the emergence of a major new risk. We then recommended a defensive position towards equities, whose valuations were excessive. At this time, the global health crisis has also affected the US and Wall Street, where a collapse in stock indices wiped out more than 35% of US market capitalisation in only 20 days.

It will clearly be difficult in the next few weeks to rationally determine if the price levels of listed US companies reflect their "true" value or if share prices are still excessive seeing the as-of-yet unpredictable risks of an economic downturn. Investors expected tangible measures in order to be reassured, and they have not been disappointed for the moment by the massive support measures taken.

In the last few days, we announced that, in this context, market valuation levels offered repositioning opportunities in the medium to long term. However, seeing the speed at which prices are rebounding (+20%), we recommend remaining vigilant and not ruling out the possibility of a new phase of weakness, which may occur soon, before what seems to be the shortest bear market in history actually comes to an end.

### S&P 500 & P/E



Sources: Bloomberg, BBGI Group S.A

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**BBGI Group SA**  
Rue Sigismond Thalberg no 2  
1201 Geneva – Switzerland  
T: +41225959611 F: +41225959612  
info@bbgi.ch - www.bbgi.ch