Sevens Report Alpha Webinar:
Is It 1998 or 2000 – Updated

Thursday, February 5th, 2020

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Goals for today's webinar

- What are the two indicators we identified in October saying about future economic growth?
- What's happening with the yield curve? Is it signaling a future slowdown?
- Can global central banks just lower rates further and avoid a slowdown? (The answer isn't as clear as you might think).
- What is the Wuhan virus's impact on the global economy? Can it cause a global slowdown that hurts stocks?

Key Question Going Forward:

Is it 1998?

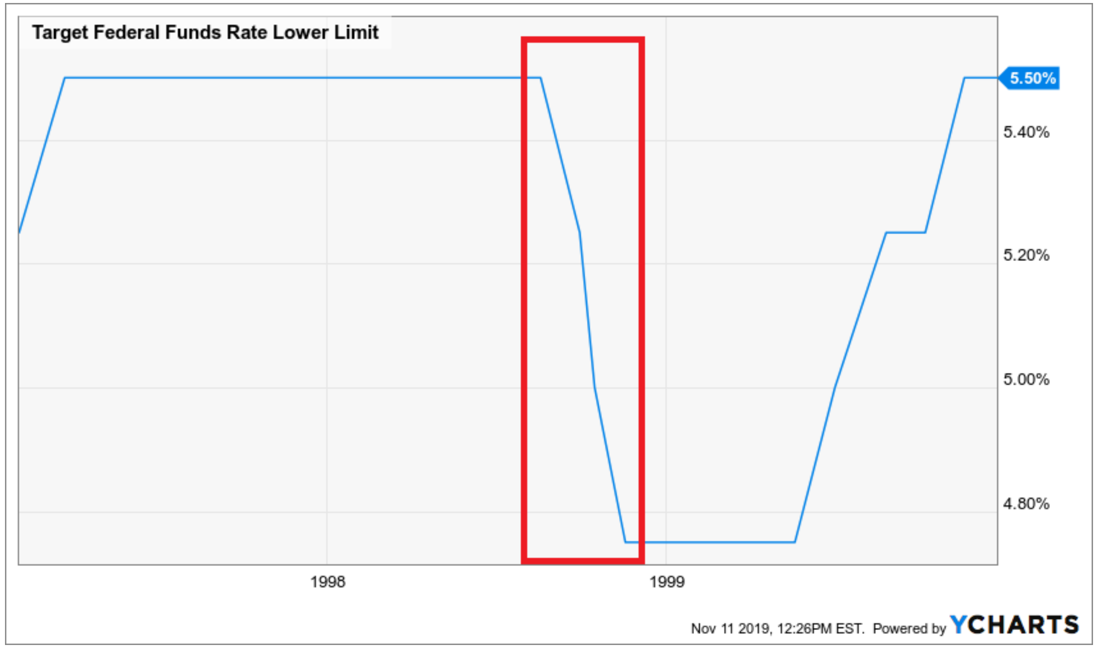
Or

Is it 2000?

- What are the two indicators we identified in October saying about future economic growth?

1998: Three Rate Cuts Extend the Expansion

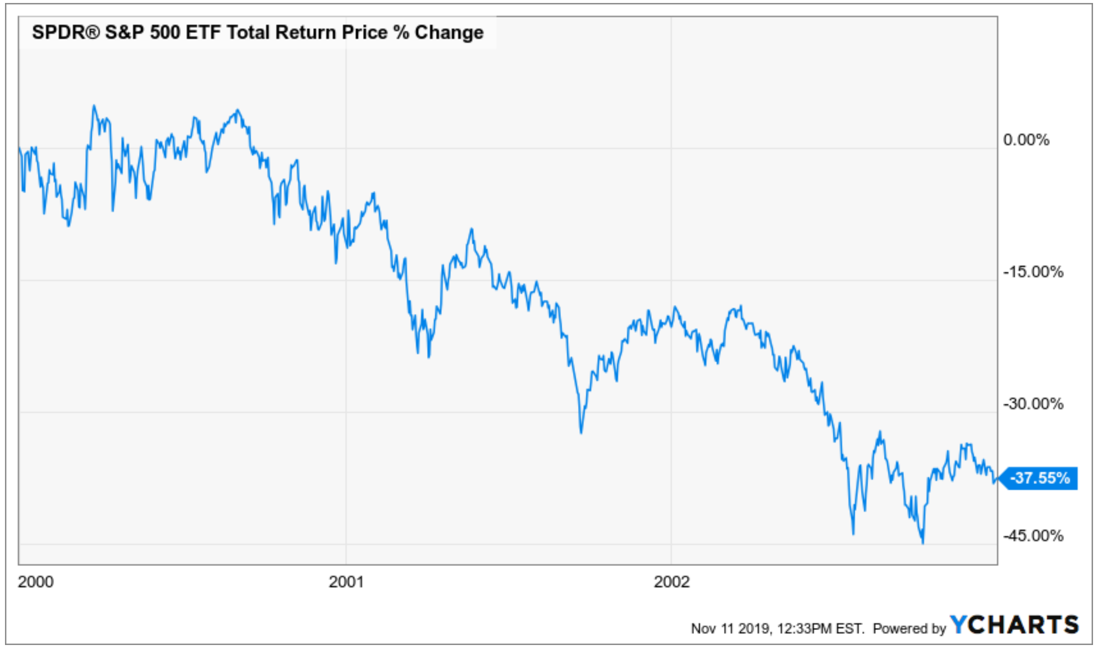
- In 1998 the Fed cuts rates three times and avoided a recession.



From June 1st, 1998 to January 1st, 2000, the S&P 500 rose 36% and the economy avoided recession.

2000: Rate Cuts Weren't Enough

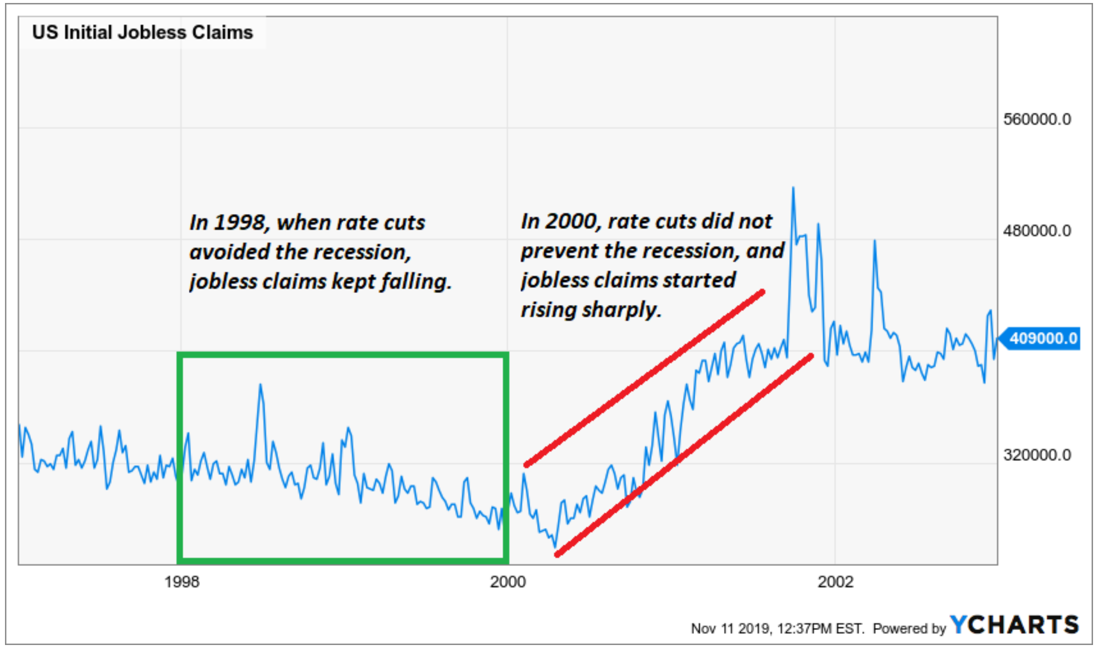
- In late 2000, the Fed cut rates, but it was already too late, and the economy was in recession within a year.

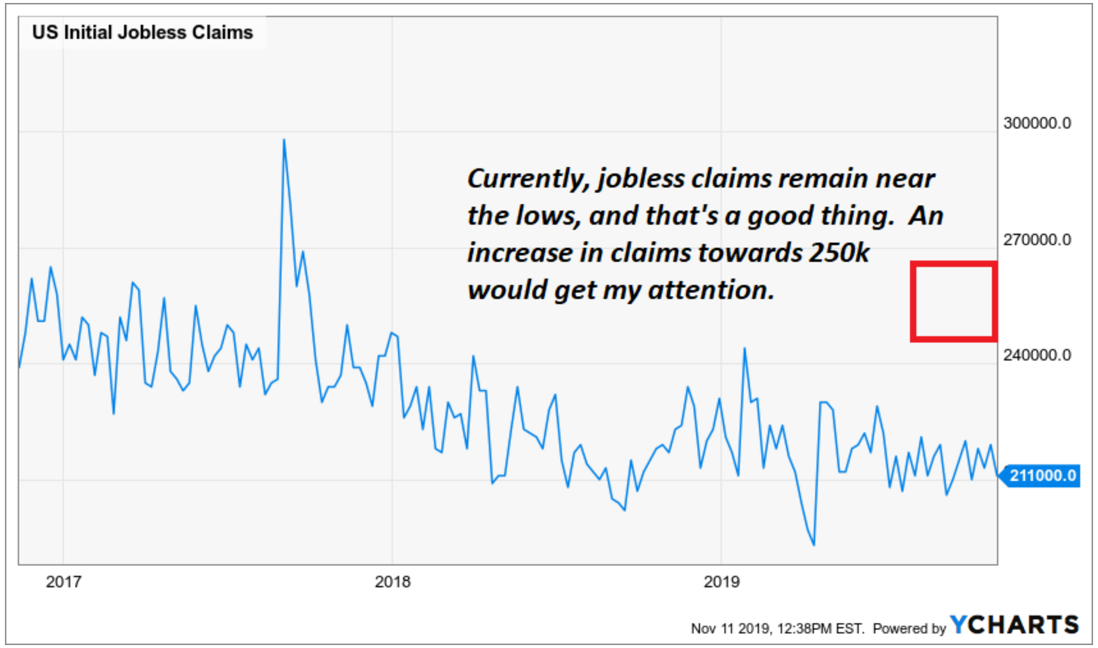


So, Is It 1998 or 2000?

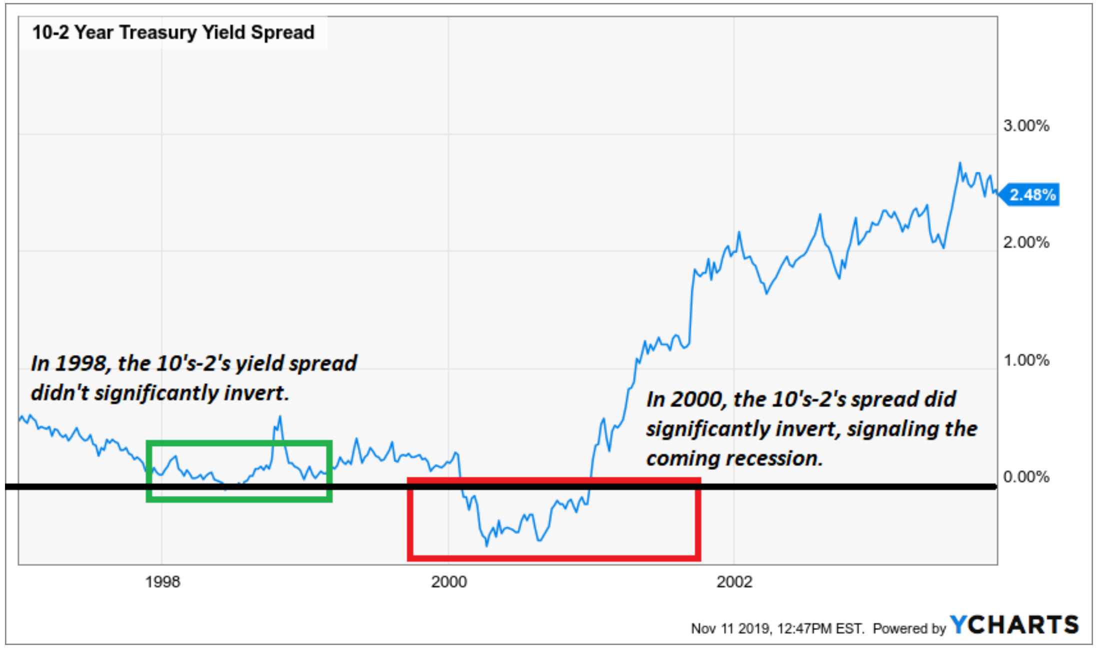
We don’t know, but we know indicators to watch.

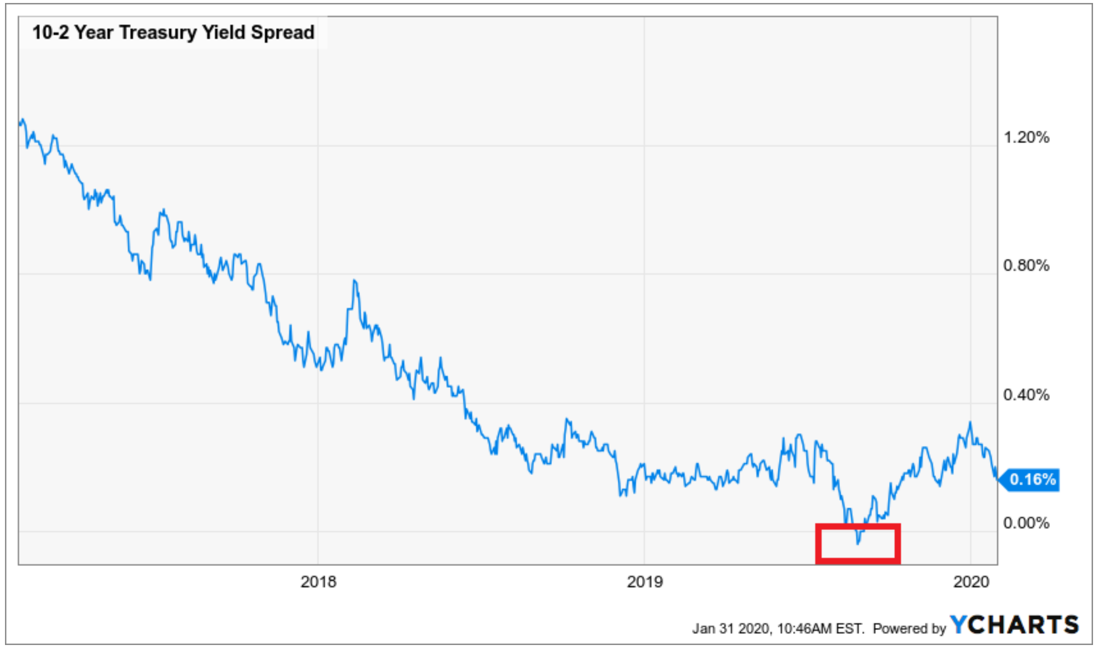
Indicator 1: Jobless Claims





Indicator 2: 10's-2's Yield Spread





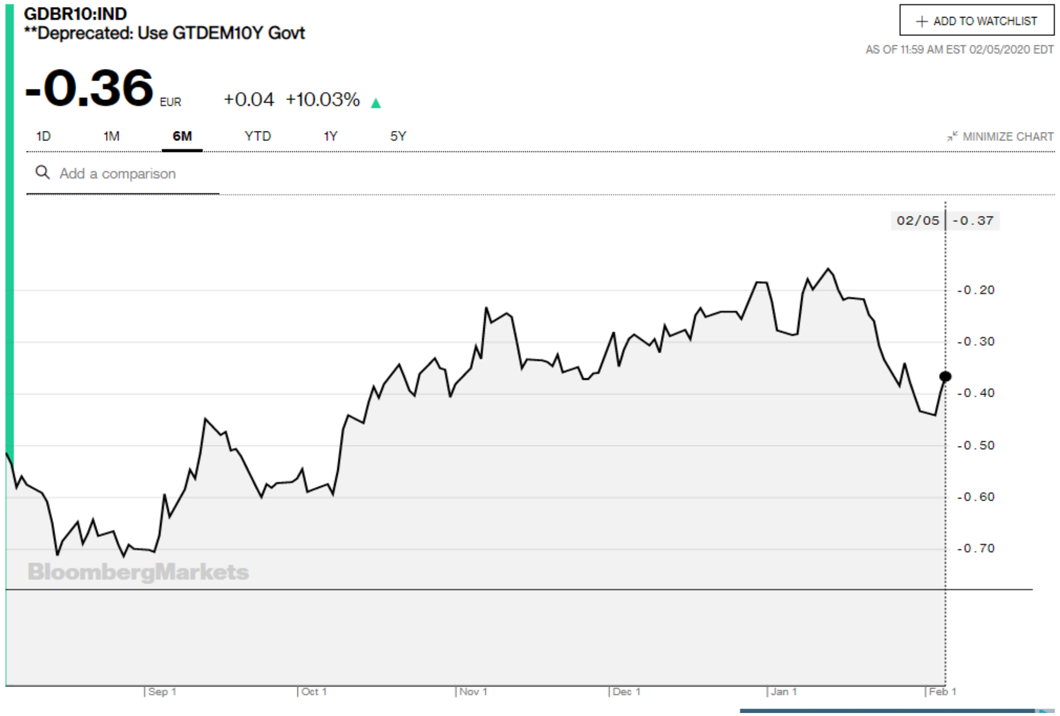
Why Aren't Rates Rising?

Multiple Reasons

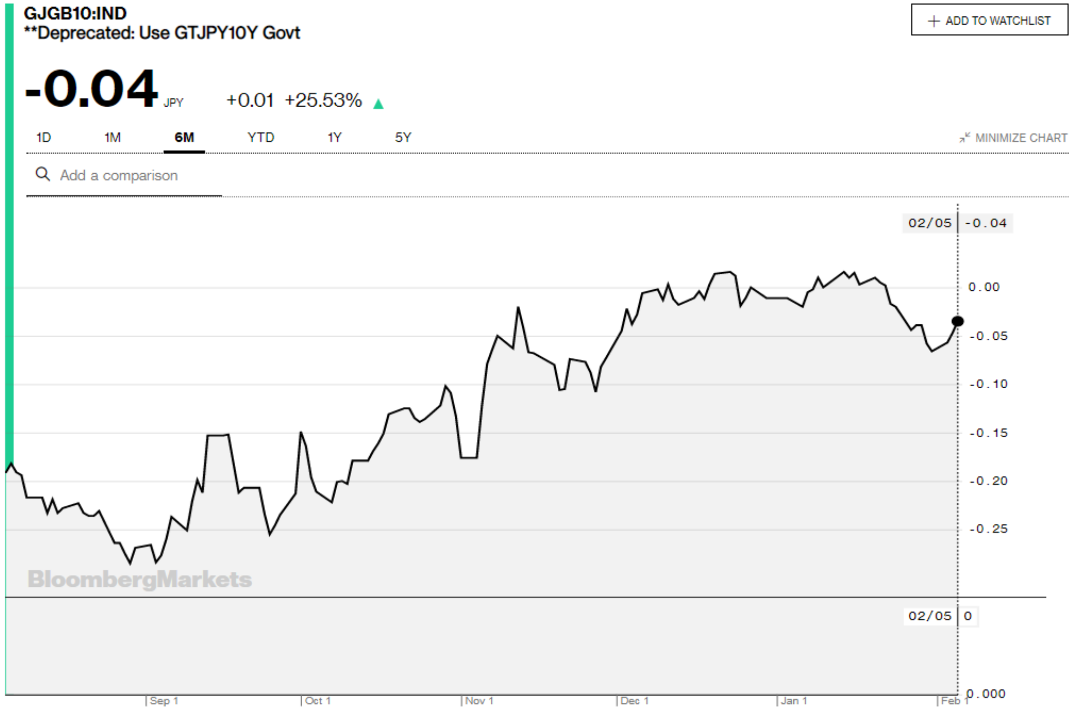
- Part of the answer is because global yields are so low.
- Part of the answer is the Fed (promising not to raise rates until inflation rises).
- But, part of it is also growth concerns. **If the market believed low rates would spur more growth and inflation, then the 10 year yield would be above 2%.**

Why Aren't Rates Rising?

German 10 Year Yield

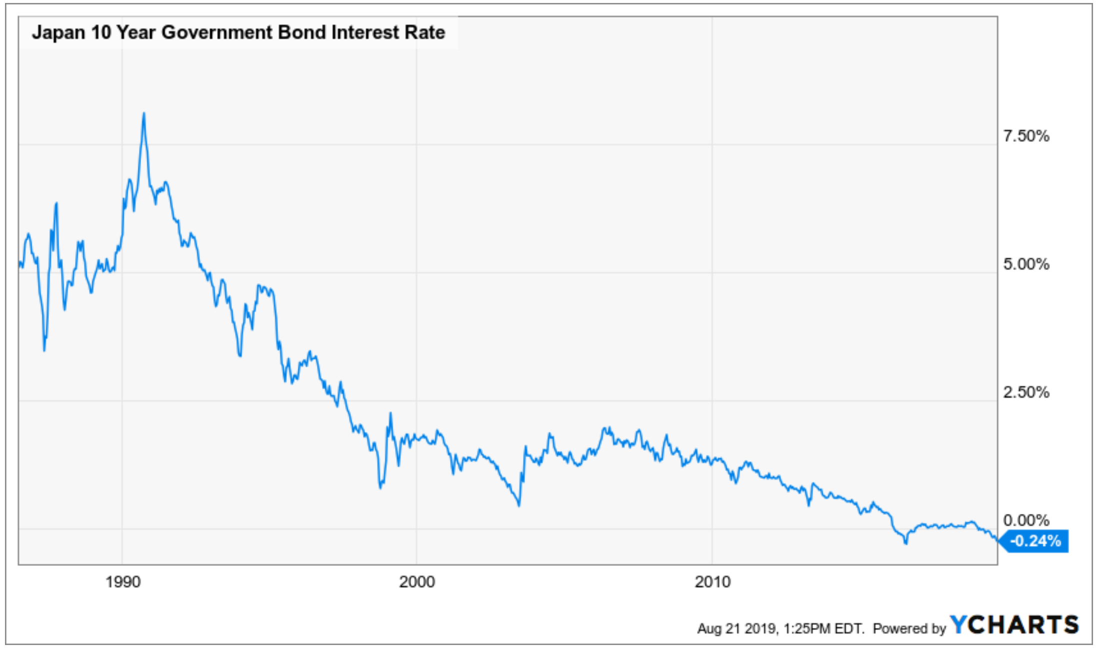


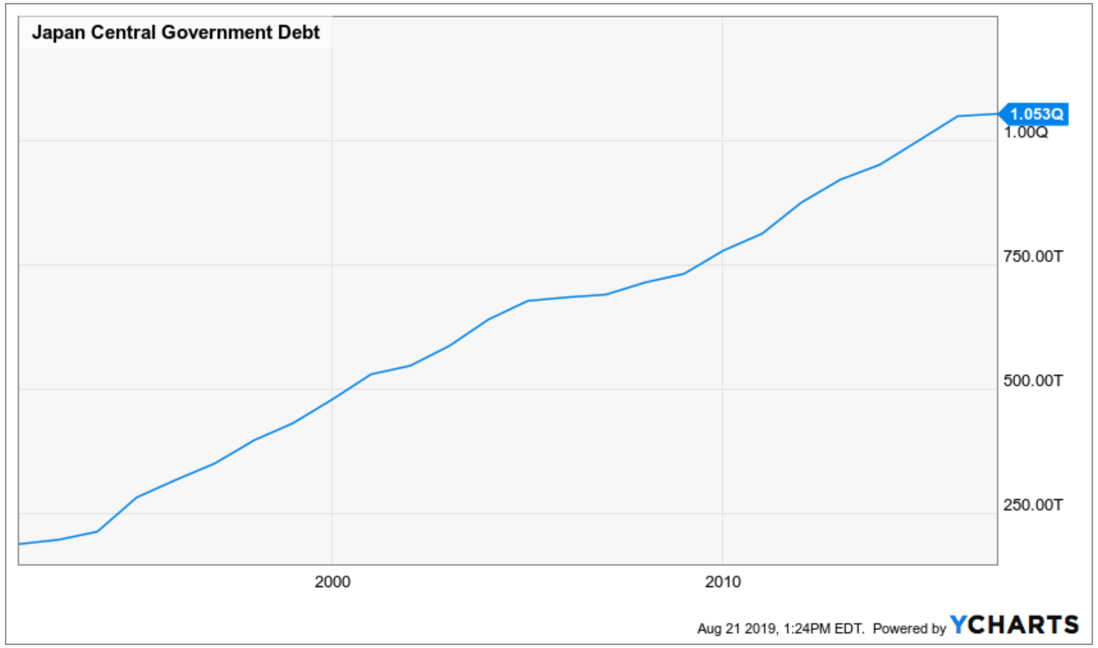
JGB 10 Year Yield



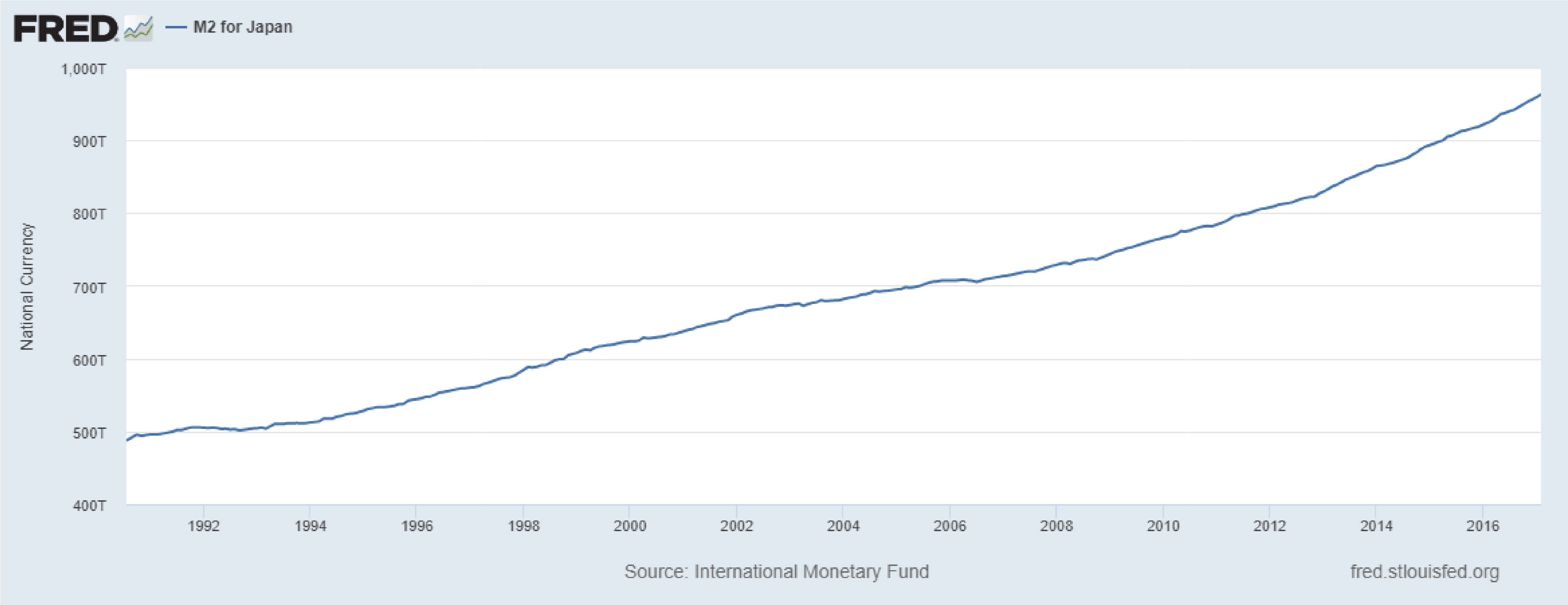
- Can’t global central banks just cut rates more and create growth?
- No! It doesn’t work that way – that’s the road to Japanization

Japanization in Pictures – Forever low rates and exploding debt levels.

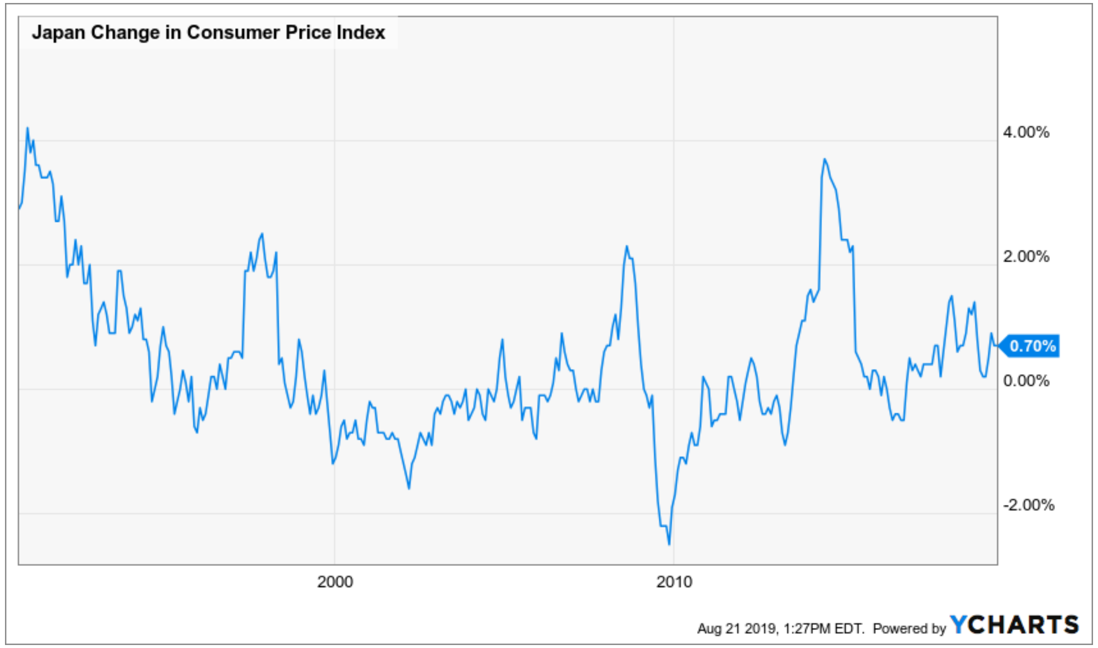


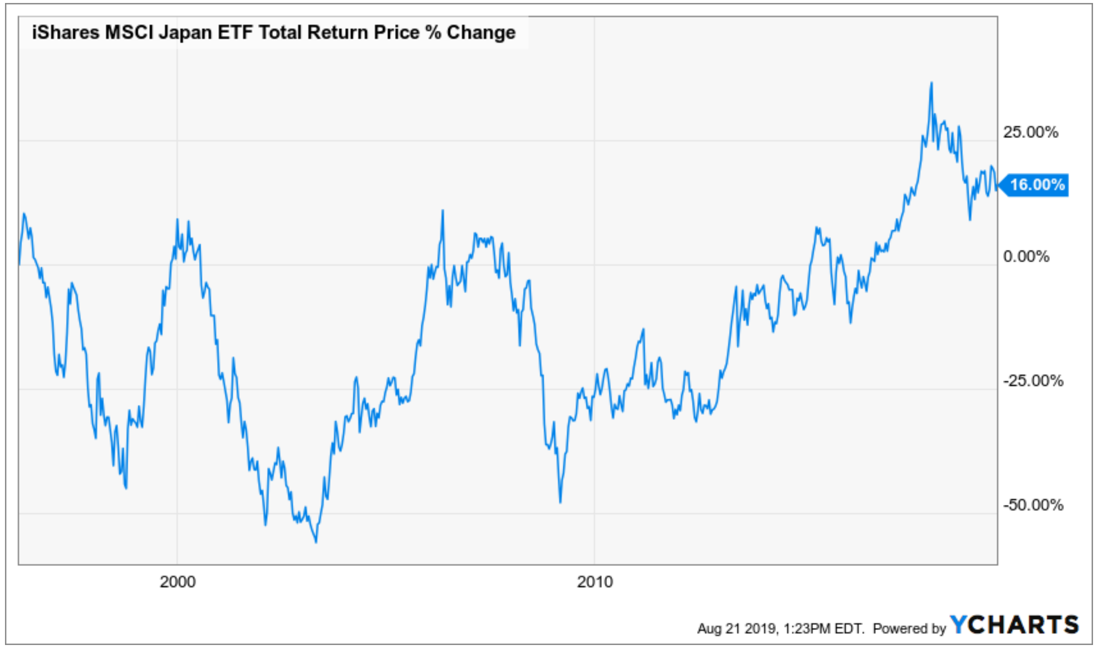


Japanization in Pictures – Exploding Money Supply



Japanization in Pictures – No Inflation and No Share Price Appreciation





- Point being: Global bond yields need to start moving up – soon!
- Those high yields will signal rate cuts and ECB QE are going to lead to better economic growth - which is what happened in 1998 and led to the 30% gains in stocks.
- Until we see Treasury yields start to rise, and the 10's-2's spread move higher, we can not definitively day this is 1998 – it still could be 2000.

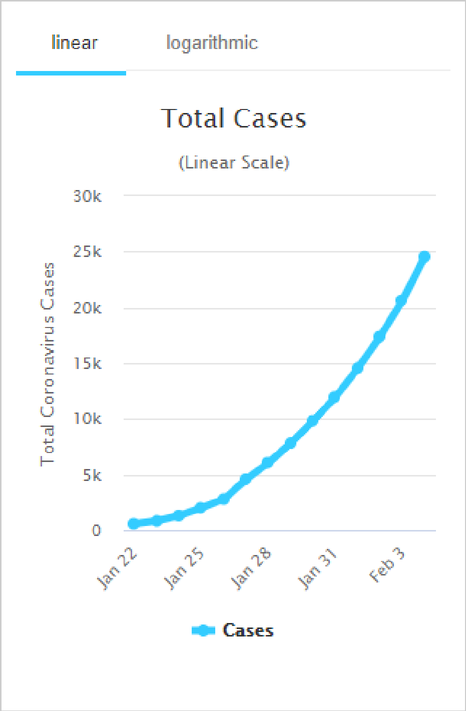
- How Does The Wuhan virus impact all of this?

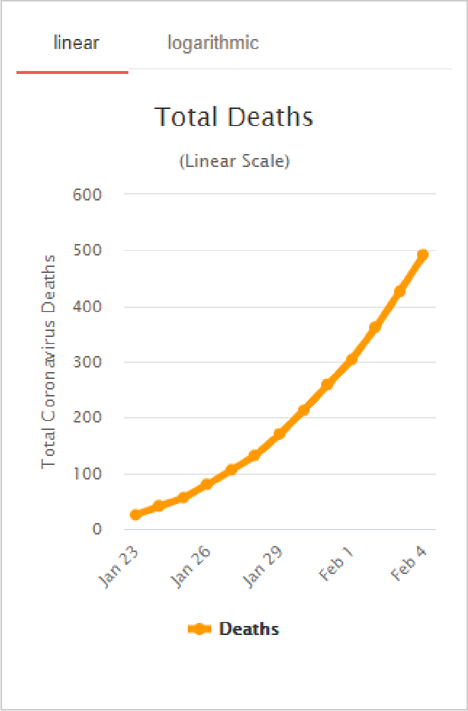
How Will The Wuhan Virus Impact The Economy and Markets?

- The Wuhan Virus started to hit markets on January 16th.
- Since then, the virus has spread, and most major brokerage firms have cut global GDP estimates for Q1 – but almost all of those cuts are coming from expected lower GDP in China.
- For example: JPM cut Q1 2020 global growth from 2.6% to 2.3%, but virtually all from China.

How Does The Wuhan Virus Impact The Economy and Markets?

- Two Key Assumptions on Wuhan virus:
- First, that the spread of the virus peaks in the next month or so.
- Second, that impacts from the virus have largely run their course by the end of the 2nd quarter.
- Key metric to watch is the <u>transmission rate. It needs to start slowing and soon.</u>





So, is it 1998 or 2000?

- Updated answer:
  - It's probably still 1998 (so the outlook remains positive).
  - But
    - Yields are not rising they way they should
    - The yield curve is not steepening the way it should
    - Part of that is due to QE, 0% rates, etc. But not all of it. The biggest risk to the U.S. economy remains that there is a global slowdown, and that it eventually pulls the U.S. economy into recession.
    - This was the fear back in the summer of 2019, and that fear is still present and the global economy faces a new headwind in the Wuhan coronavirus.
    - Bottom line, the outlook remains positive, but this is no time to be complacent, and we won't be.