As US 10 year Treasury yields reach new lows...

...the outlook for US interest rates also suggests a downward shift and further volatility ahead.

Source: Bloomberg as at March 6, 2020.

The recent fall in US Treasury 10 year yields is extraordinary and suggests an air of panic. The ongoing economic shock will prompt further action from central banks although this may not be in the form of just interest rate cuts. Risk assets, such as equities and credit, have been holding up relatively well (better than has been suggested by the move lower in US Treasury yields) and maybe we are seeing capitulation in these areas now thereby increasing the demand for safe haven asset such as US Treasuries.

One further observation is that markets may become less liquid and therefore price action can be exaggerated in that kind of environment. Given many investors will have been caught out by resulting economic effects of the COVID-19 coronavirus outbreak it is also likely there may be liquidation of positions that are no longer appropriate. It is likely we will see further corporate (and perhaps government) casualties as a temporary hit to cash flow could translate into a liquidity event resulting in perhaps payments being missed and, in extreme cases, possibly defaults.

In addition to this, news of a break down between OPEC members on oil production cuts and the subsequent planned price war have added another dimension to the crisis. Ultimately a collapse in the price of oil will stimulate economic growth but in the meantime the markets are worried about the potential fallout from the collapse in revenues for various leveraged oil producers.

This is adding to the sense that the markets are becoming dysfunctional and we may have to work through an increase in defaults before there is stability. We continue to look for a change in the response to the coronavirus from the authorities from restricting activity to coping with its effects. Until then we will expect to see further economic shocks and market turmoil.

*Paul Brain, head of fixed income, Newton Investment Management.*
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