BROOKS MACDONALD

COVID-19: Weekly Round-Up

20 April - 24 April 2020

IN BRIEF

- Positive gains were recorded as markets look forward to the exit from lockdown despite challenges to market risk appetite.
- A plunge in the price of oil futures rippled across broader assets throughout the week.
- There is still no concrete decision from EU leaders on what an EU recovery fund will consist of.

OUR VIEW

Monday

Last week European and US markets rallied for their second consecutive week for the first time since mid-February. Positive gains were recorded as markets look forward to the exit from lockdown despite two key challenges to market risk appetite. First, Covid-19 continues to test Eurozone political unity, with the next key date for Italian stress expected this Thursday where an EU summit is expected to debate joint issuance to provide region-wide stimulus. Second, concerns around oil over-supply continue despite the recent OPEC+ production cut, as oil demand remains weak.

Tuesday

Global risk appetite faltered after a plunge in the price of oil futures rippled across broader assets. There were some extraordinary numbers on show with West Texas Intermediate (WTI) crude oil contracts for May delivery trading at almost -$40 as traders were forced to pay other market participants to take oil off their hands. The negative price was a reflection that with a collapse in near-term energy demand, and a lack of storage space for WTI at Cushing, seen as a land-locked pipeline crude, the cost of storage briefly exceeded the value of the underlying commodity.

Wednesday

It was another risk off day for markets driven by three factors: further weakness in the oil price, concern about the EU Council meeting on Thursday and weaker US corporate earnings. Equities sold off across the board however the weakness was particularly pronounced in European banks which were almost 50% lower since the start of the year. The main focus of the market remains the oil price however, and any hope that Monday had seen the last of the technical squeeze was short-lived. Weakness was seen across both WTI and Brent. Looking forward, while we would expect Brent as a seaborne crude market to be able to adapt more flexibly to the storage issues we have seen in Cushing, there remains a risk to this market too and this has weighed on sentiment further.

Thursday

It's not often that a geopolitical tension can lead to a market rally but the comment by US President Donald Trump that he had authorised US navy vessels to fire at Iranian gunboats if they harassed US ships at sea, led to a surge in the oil price that the equity market appreciated. Markets were left to speculate that in the absence of a demand increase or a supply cut this Presidential tweet may have been partially designed to support the oil market. Elsewhere, a €2trn fiscal support package which would be partially financed from the EU's medium-term budget but also via a temporary financing mechanism was reported. This financing mechanism is effectively joint-debt and something that the EU has previously shied away from. Fiscal spending from the EU budget is less politically complex and therefore something that was more likely from the communique. Arguably it was more likely that the monetary union of the Eurozone was to adopt joint burden sharing than the full EU, so we have taken this leak with a pinch of salt. Regardless the key for sentiment will be progress and specifically progress towards something that coronavirus-impacted Southern countries are willing to sign up to.

Friday

The Euro began the day more strongly, however any hope that the EU leaders summit would agree burden sharing quickly evaporated and with it the gains in the single currency. In many ways Thursday was textbook Europe, gradual movement towards an almost inevitable final goal however a lack of details which really signifies a lack of agreement. The question appears to be whether the payments to stricken nations will be treated as grants, effectively handouts, or loans that need to be repaid. Currently the debate is the ratio between grants and loans and how the Fund is financed. Tellingly, there is no timing yet as to when the Fund's resources would be available to member states. Whilst economists have differing views on the shape of the post-coronavirus recovery, any delay in an economic boost risks being too late to help Southern bloc countries such as Italy.

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