MARKET INSIGHTS

MACKENZIE Investments

Mackenzie Fixed Income Team May 27, 2020

Global Macroeconomic Update

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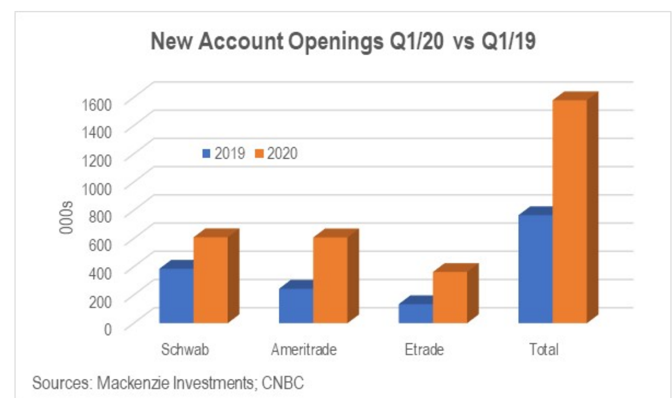
Key themes:

- Since the peak of the crisis, equity and fixed income markets have been somewhat bifurcated; flows could be at least partially to blame, somewhat masking the state of the real economy
- The US, UK, Canada, Australia and New Zealand are holding the line at effective zero rates while talk of "going negative" has amplified in recent weeks
- If one of those five central banks eventually does go negative, it likely won't be alone

Holding the Line (at Zero) – For Now

The ongoing bifurcation of risk markets versus the state of the real economy continues to confound many. Clearly equities have remained bid since near the peak of the COVID crisis with many institutional players perplexed as to why given the economic carnage that looms, both known and unknown. And while we want to stick to our lane and provide a fixed income perspective, in some ways what we are experiencing, we believe, is at least in part the derivative of a flow-based rally, as opposed to one that has been purely or primarily fundamentally driven. What has struck us with particular interest has been the massive number of new account openings – presumably new money coming into the market mostly for fresh longs - at the largest online brokerages in the first quarter (see chart). For example, new account openings increased by a combined 107% - or about 1.58 million - in the first quarter of 2020 using data compiled by Etrade, Schwab and TD Ameritrade. New accounts! Add on new accounts at Robinhood that number balloons to over 4.5 million in the first quarter. When Schwab's CEO says the firm saw 27 of the largest 30 volume trading days in its history in the first quarter, you know something is going on. Anecdotally, we are seeing commentary that the lack of live sports has caused a pivot to "wagering" on markets (yikes!), while options activity has also increased noticeably. So it appears to us, at least at a minimum, that a decent part of the ebullience in risk assets appears to be flow-based, and not necessarily fundamental.



Sources: Mackenzie Investments; CNBC

So why is the macro fixed income guy going on about new account openings? If you believe that risk assets are getting propped up by new money flows, the economic outlook continues to look sour (along the path of the "Nike Swoosh" as we have been advocating) and there is actually more structural damage in the economy to come (defaults, bankruptcies and the like), then deflationary pressures are likely to persist and the Fed and other central banks could have more work to do in terms of their monetary response. This is where the negative policy rates story comes into play, despite the risk rally, since policy rates are already so low and / or at the zero lower bound (ZLB) in many economies.

There is an interesting situation developing within the G10 space where the European Central Bank (ECB), Swiss National Bank (SNB) and the Bank of Japan (BoJ) clearly moved to negative policy rates a few years ago, but the other major central banks – in particular the other "big five": Canada, US, UK, Australia and New Zealand – are doing their very best to hold the line at or near the ZLB (trying not to take policy rates negative or below zero). Our view is that if one of the so-called other big five central banks goes negative on its policy rate, there is a strong probability another central bank – and possibly more of the five - will follow. To us it seems more likely that there would be some "loose coordination" between one or more of the other big five central banks and so we continue to monitor data and commentary from all five for clues as to whether this group will go negative.

Clearly the elephant in the room here is the Fed and would it take its Fed Funds rate negative. Here it is important to note almost all of the academic research or commentary coming out of the Fed, whether from the Board in DC or the various District Banks, continues to suggest a negative Fed Funds rate will not have the perceived impact on the economy and credit transmission mechanism. The Fed has cited both the ECB and BoJ examples: that inflation failed to materialize in both economies while the negative policy rate put additional strain on the respective regions financial systems. Where we have recently started to see some fraying from holding the ZLB line though has been from the UK and New Zealand; recent commentary

from Bank of England officials suggest its staff are in the process of performing more of a "deep dive" on the impact of negative rates, while the Reserve Bank of New Zealand (RBNZ) has recently noted negative rates are not imminent but very much a potential part of the toolkit perhaps later this year. The RBNZ commentary is particularly interesting to us given its place in history as the first major central bank to institute an inflation-targeting system in the early 1990s and therefore is known in central banking and academic circles as a leader in policy management despite the relatively small size of its domestic economy. A move by the RBNZ that takes its OCR rate negative would not go unnoticed by the other big five central banks, nor us. We continue to expect front-end yields in both Canada and the US to head lower in the weeks and months ahead – even if the equity "rally" persists – as bankruptcy and default rates rise, the unemployment rate remains sticky, government fiscal measures prove to be not quite enough and the theme of negative policy rates continues to be a key topic as a lack of inflationary pressures remains persistent.

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