svb Asset Management

Quarterly Economic Report

Inside views on economic and market factors affecting global markets and business health

Q2 2020

Quarterly Economic Report

Published in Q2 2020 | Data for Q1 2020

Overview of Q1 2020

What a quarter it has been. In a matter of months, the world as we knew it has changed and the global economy was thrown into uncharted territory.

The situation surrounding COVID-19 has initiated large-scale shelter-in-place orders globally and the widespread implications this has had on both businesses and individuals has effectively brought economic activity to a standstill. We are just now starting to see this reflected in economic data. As of mid-April, within a four-week span, US jobless claims have hit staggering levels with 22 million people filing for unemployment amid the pandemic. Q1 GDP reflected the beginning of a recession with a 4.8 percent contraction. The big questions now are how long this will last and what the ultimate impact on the global economy will be.

What has been encouraging to see is how swiftly the Federal Reserve has acted. The Fed has stepped in to do everything they can with their series of "financial crisis era" measures to instill a sense of calm in the markets, which also included an outright injection of a massive amount of liquidity into the system. As a result, we've seen market functioning normalize in recent weeks, and it appears the Fed has no plans to let this falter.

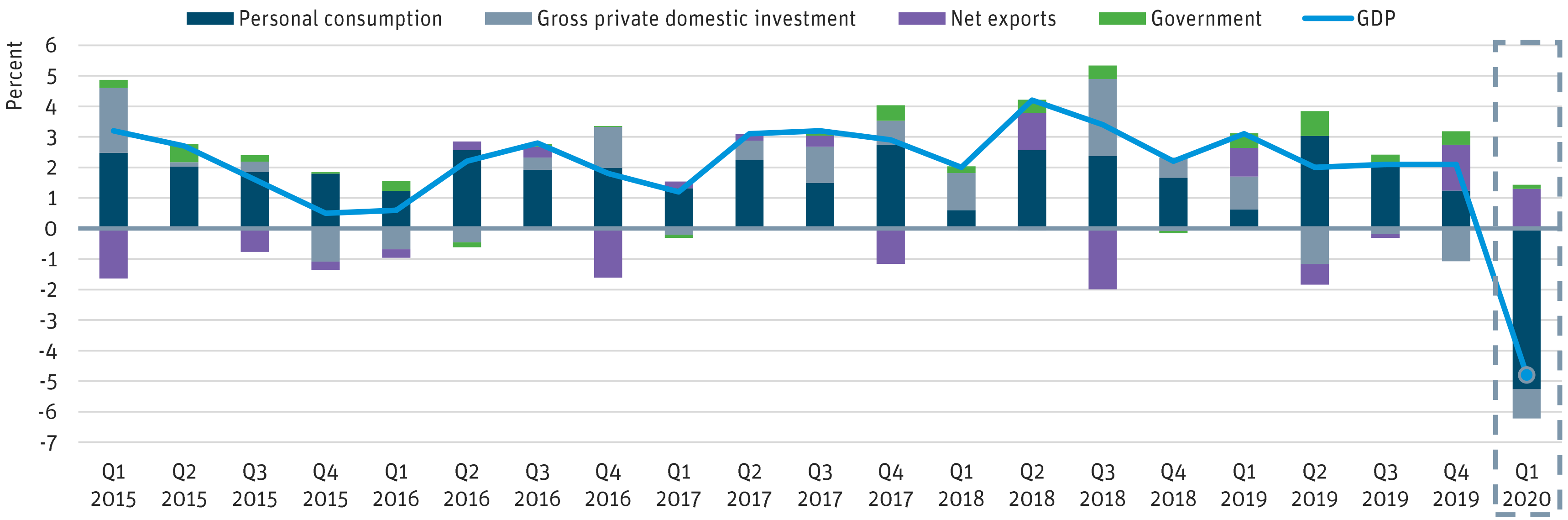
Looking ahead, many uncertainties remain. Recognizing the strain the pandemic has on our corporate clients, on individuals and on the broader economy, we remain steadfast in our commitment to navigate investment portfolios through volatile and uncertain times with a high degree of focus on capital preservation and liquidity, in addition to achieving competitive market returns. We hope everyone is staying healthy and safe.

Domestic Economy

GDP: Upended by COVID-19

Q1 GDP fell by 4.8 percent compared to forecasts of a 4 percent decline. The negative number reflects the beginning of a recession. Consumption, the biggest contributor to US GDP, fell 7.6 percent – the most in almost 40 years. Better than expected inventories and residential investment helped the overall figure, however, these contributions are going to weigh on the economy next quarter, which is expected to be negative as well. The length and long-lasting effects of shelter-in-place will have a significant impact to economic activity.

GDP and Components

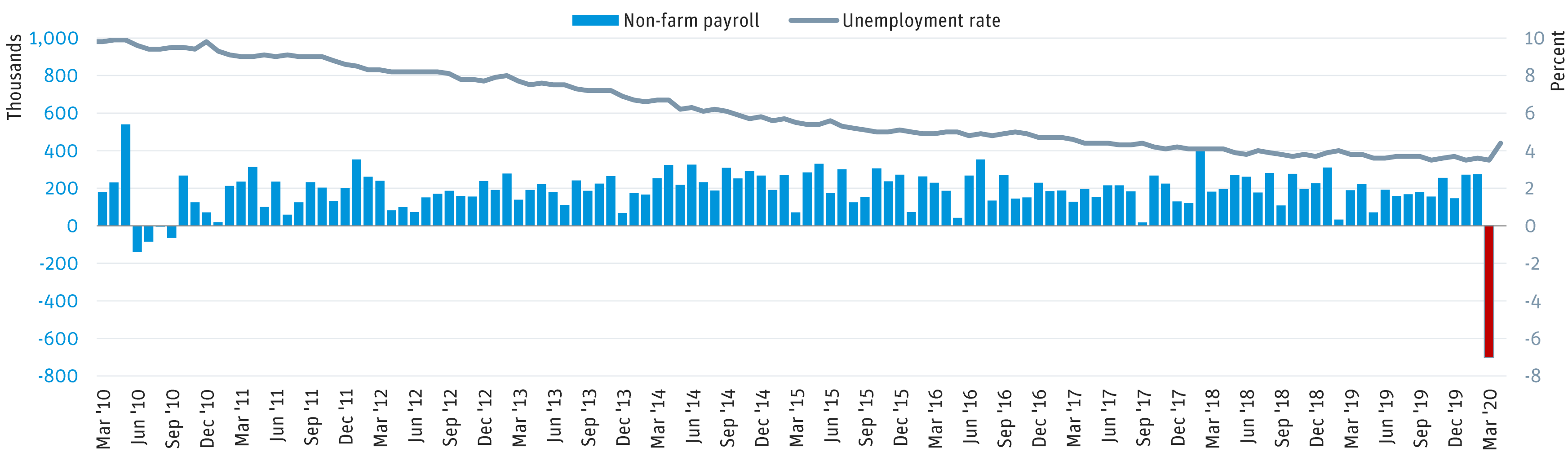


Sources: Bureau of Economic Analysis, Congressional Budget Office and SVB Asset Management. Data as of 4/29/2020. GDP values shown in legend are percent change vs. prior quarter on an annualized basis.

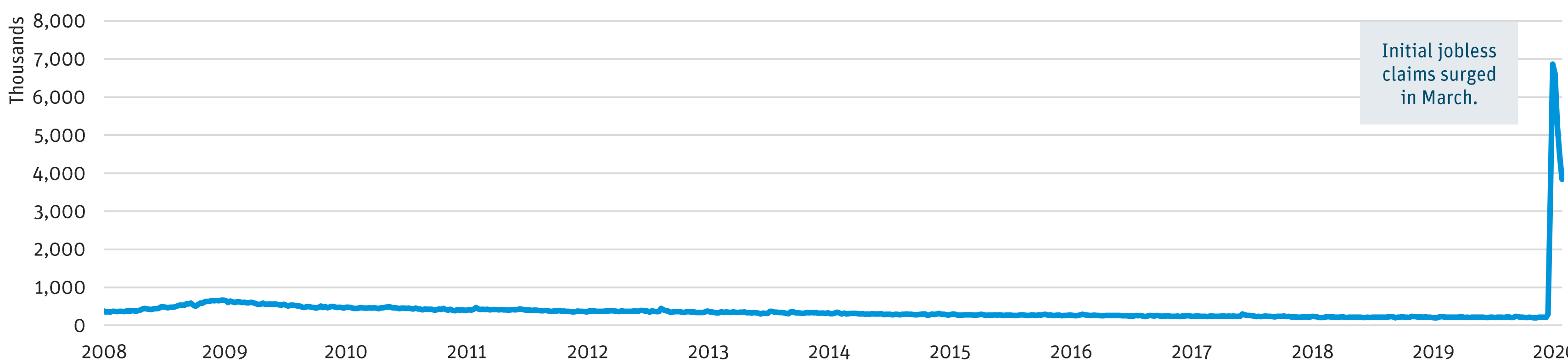
Employment: Abrupt end to job growth

After just over nine continuous years of positive job growth, the US experienced an abrupt shock to the employment market triggered by COVID-19. Initial jobless claims surged to over 10 million in March, non-farm payrolls contracted by 701,000 and the unemployment rate increased to 4.4 percent.

Employment Landscape



Initial Jobless Claims: Glimpse of what's to come



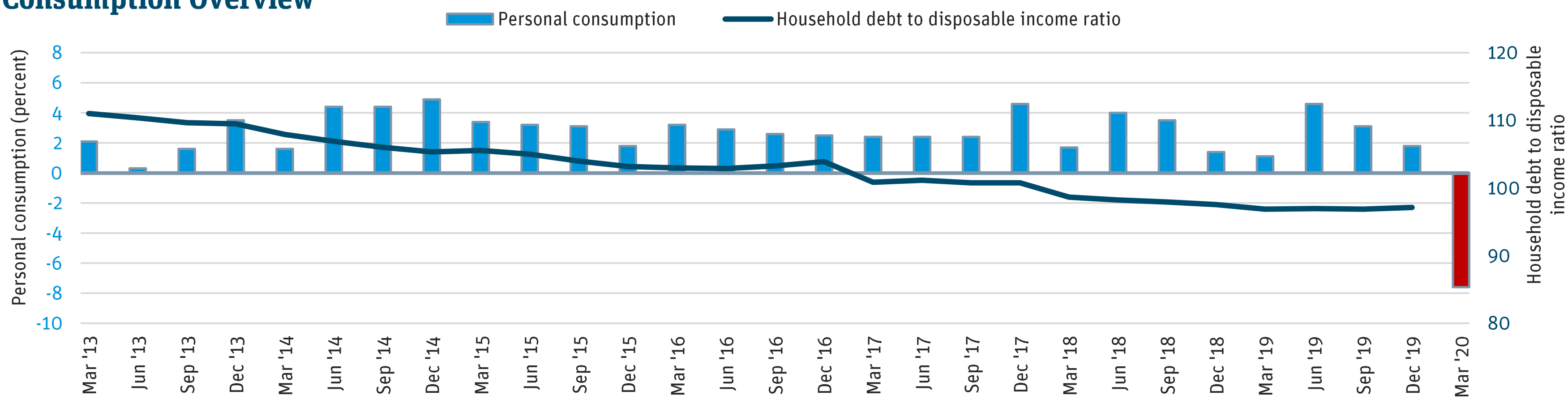
Sources: US Bureau of Labor Statistics, Bloomberg and SVB Asset Management. Data as of 4/29/2020.

0520-0145MS-103120

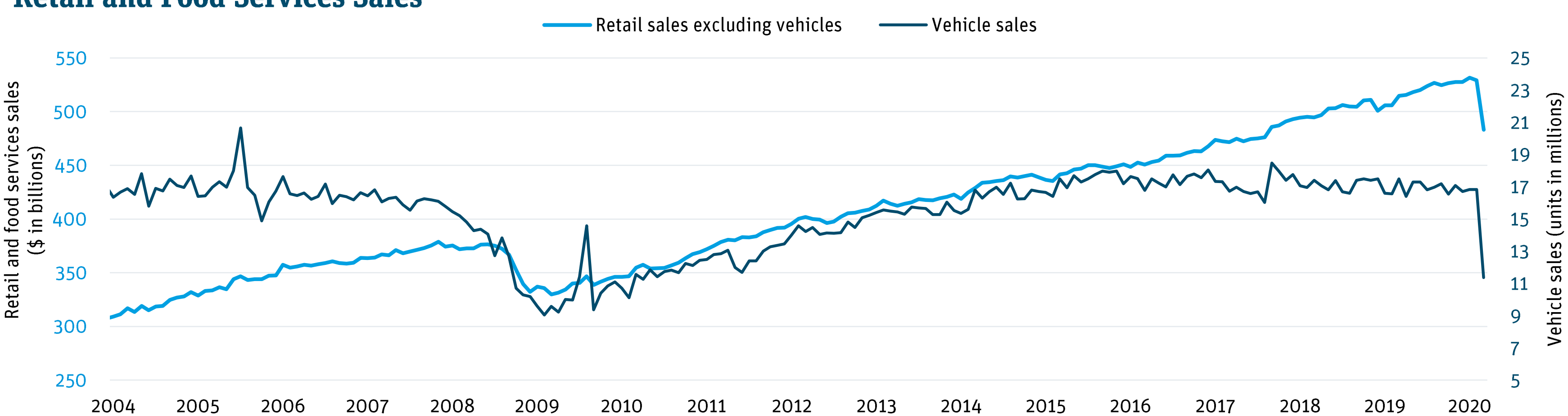
Consumption: Consumer scales back

As expected, the dramatic rise in unemployment, combined with a nationwide shelter-in-place mandate, stalled consumer spending with a contraction of 7.6 percent compared to estimates of 3.6 percent. In March, apparel, furniture and restaurant sales fell 25 percent to 50 percent, while grocery sales spiked a record 27 percent. As the shelter-in-place continues for much of the country, retail sales will continue to see downward pressure.

Consumption Overview



Retail and Food Services Sales

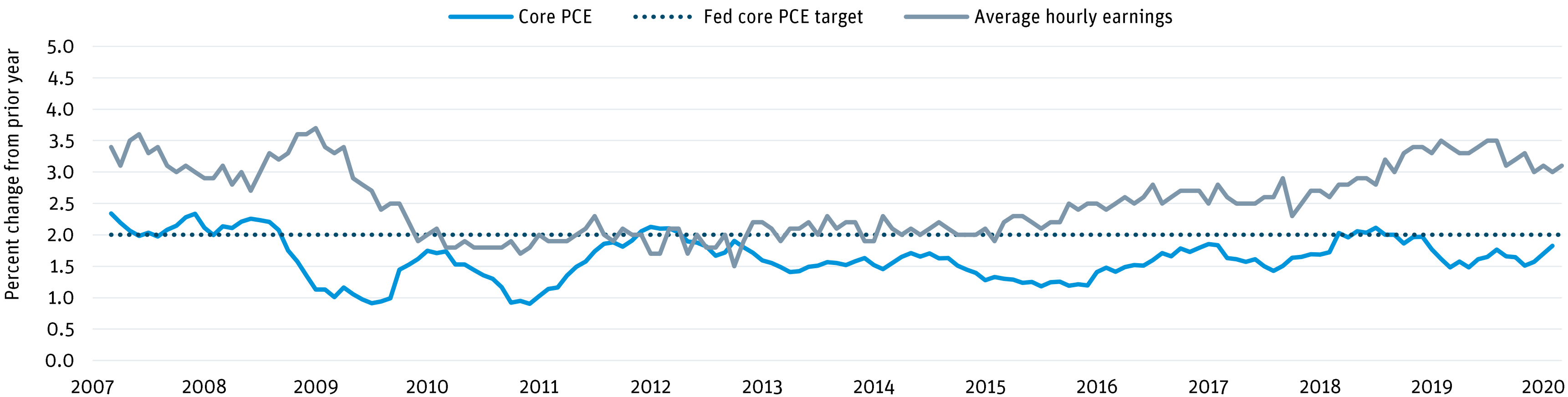


Sources: Bloomberg and SVB Asset Management. Data as of 4/29/2020.

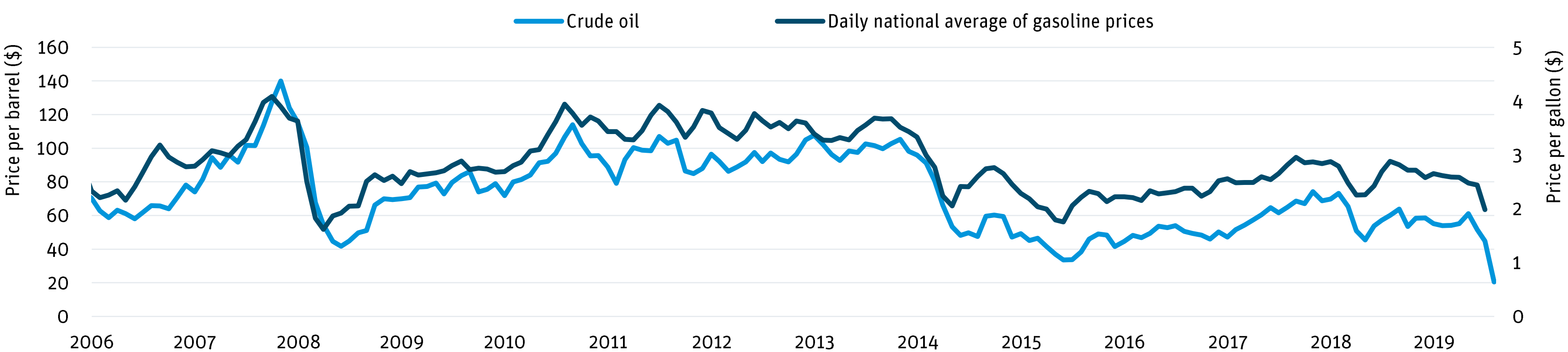
Inflation: Monitoring closely

The effects of the Fed's swift monetary policy action with a total of 150 bps cut in March, coupled with an unprecedented use of additional monetary policy tools, will be closely monitored. As supply and demand dynamics play out in this relatively uncharted territory, there may be pockets of inflation. Meanwhile, oil has experienced a dramatic decline as global growth adjusts to stay-at-home policies.

Core PCE



Oil Prices



Sources: Bloomberg and SVB Asset Management. Data as of 4/13/2020.

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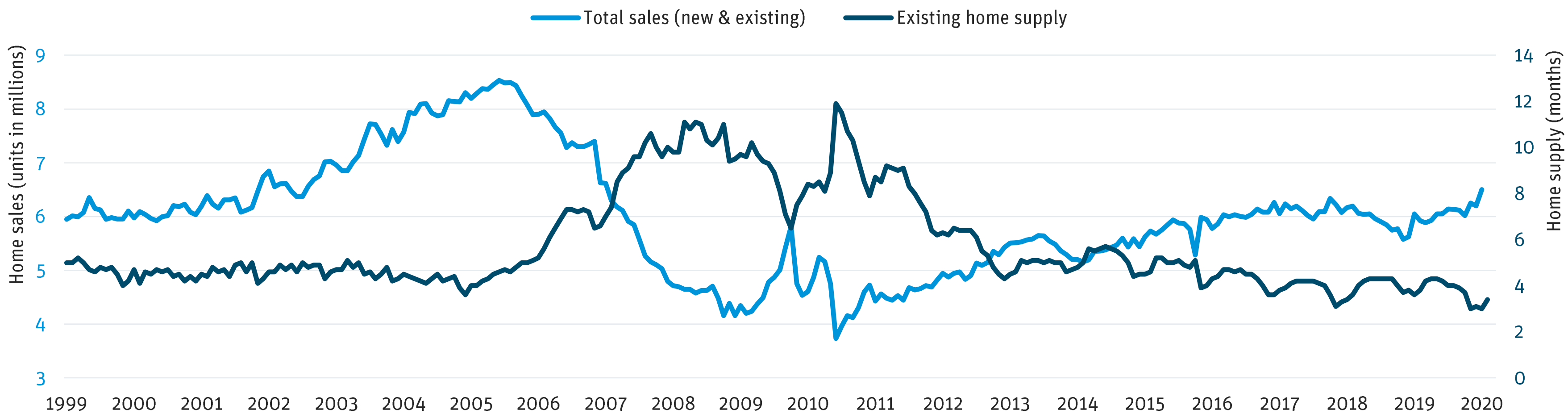
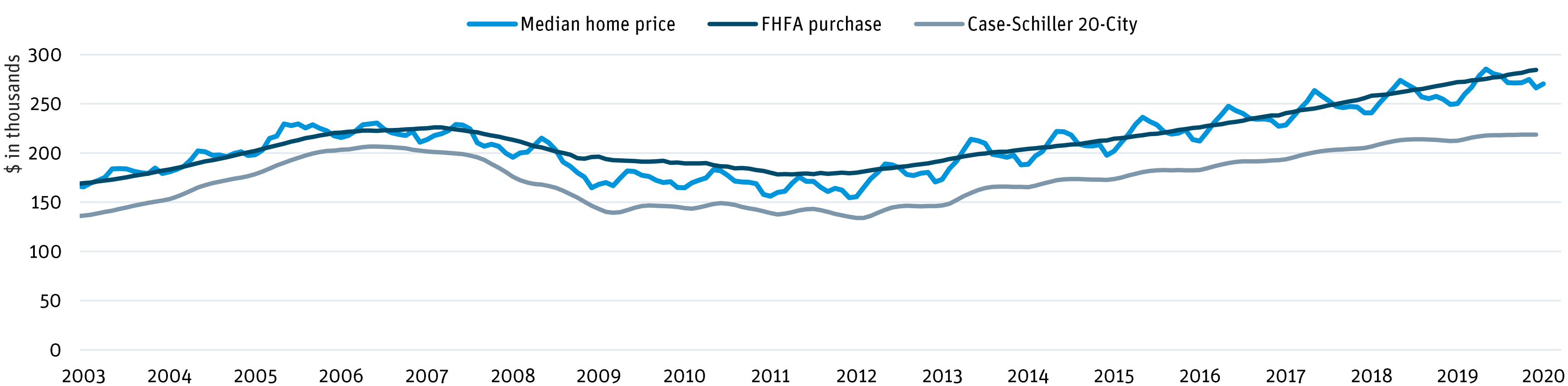
Housing: Expected to decline

Housing activity, previously a bright spot of the economy, is expected to decline as the unemployment rate climbs and the widespread effects of shelter-in-place – ranging from being able to show a home to complete transactions – permeate through the sector.

Housing Market



Home Prices

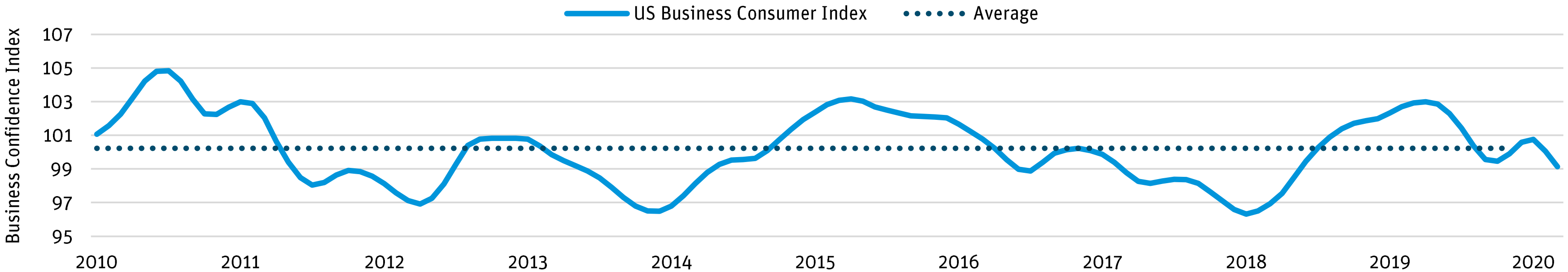


Sources: Bloomberg and SVB Asset Management. Data as of 4/24/2020.

Business Outlook: Clouded by uncertainty

After rebounding in late 2019 on an improved trade outlook, businesses were shrouded with indefinite uncertainty by COVID-19. Business confidence fell once again while business sentiment across major regions contracted precipitously. In addition, manufacturing and service sectors both contracted as very few sectors escaped the effects of the pandemic.

Business Confidence Index



Business Sentiment

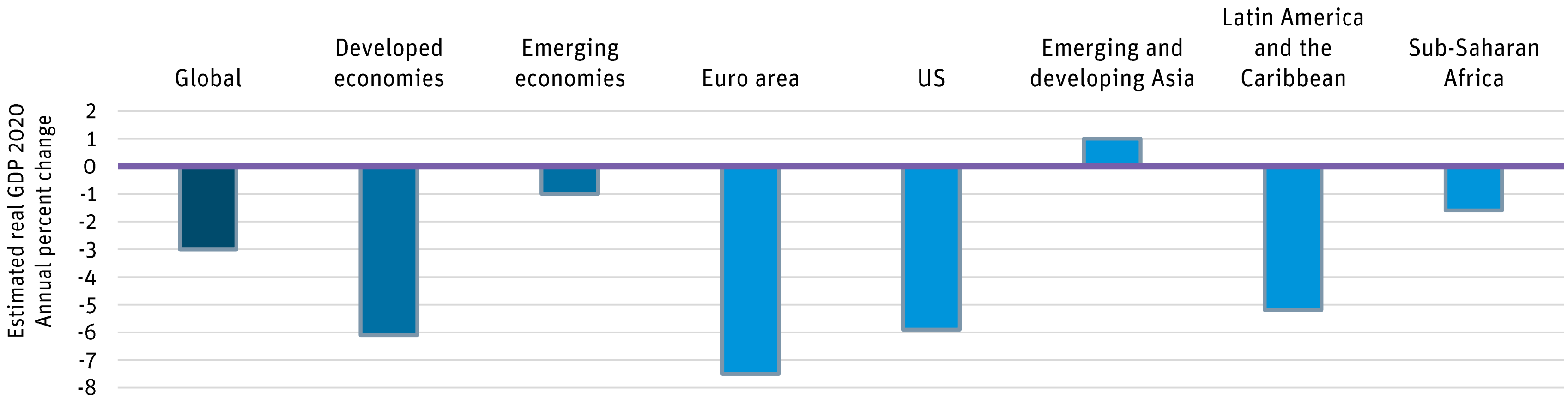
	Dallas Fed Manufacturing Survey	Philly Fed Manufacturing Survey	New York Fed Empire Manufacturing Survey	Kansas City Fed Manufacturing Survey	Richmond Fed Manufacturing Survey	ISM Manufacturing PMI SA	ISM Non-Manufacturing
October-18	28.1	19.7	20.0	10.0	15.0	58.5	60.3
November-18	16.1	11.9	21.4	17.0	14.0	58.8	60.2
December-18	-6.9	9.1	11.5	6.0	-8.0	55.0	58.0
January-19	-0.2	17.0	3.9	5.0	-2.0	55.5	56.0
February-19	11.6	-4.1	8.8	1.0	16.0	54.1	58.5
March-19	6.9	13.7	3.7	10.0	10.0	54.6	56.3
April-19	2.0	8.5	10.1	5.0	3.0	53.4	55.7
May-19	-5.3	16.6	17.8	4.0	5.0	52.3	56.3
June-19	-12.1	0.3	-8.6	0.0	3.0	51.6	55.4
July-19	-6.3	21.8	4.3	-1.0	-12.0	51.3	54.8
August-19	2.7	16.8	4.8	-6.0	1.0	48.8	56.0
September-19	1.5	12.0	2.0	-2.0	-9.0	48.2	53.5
October-19	-5.1	5.6	4.0	-3.0	8.0	48.3	54.7
November-19	-1.3	10.4	2.9	-3.0	-1.0	48.1	53.9
December-19	-3.2	0.3	3.5	-8.0	-5.0	47.2	55.0
January-20	-0.2	17.0	4.8	-1.0	20.0	50.9	55.5
February-20	1.2	36.7	12.9	5.0	-2.0	50.1	57.3
March-20	-70.0	-12.7	-21.5	-17.0	2.0	49.1	52.5
April-20	-73.7	-56.6	-78.2	-30.0	-53.0	49.1	52.5

Sources: Bloomberg, OECD and Business Confidence Index. Data as of 4/29/2020.
Heatmap colors based on the indices and time periods shown.

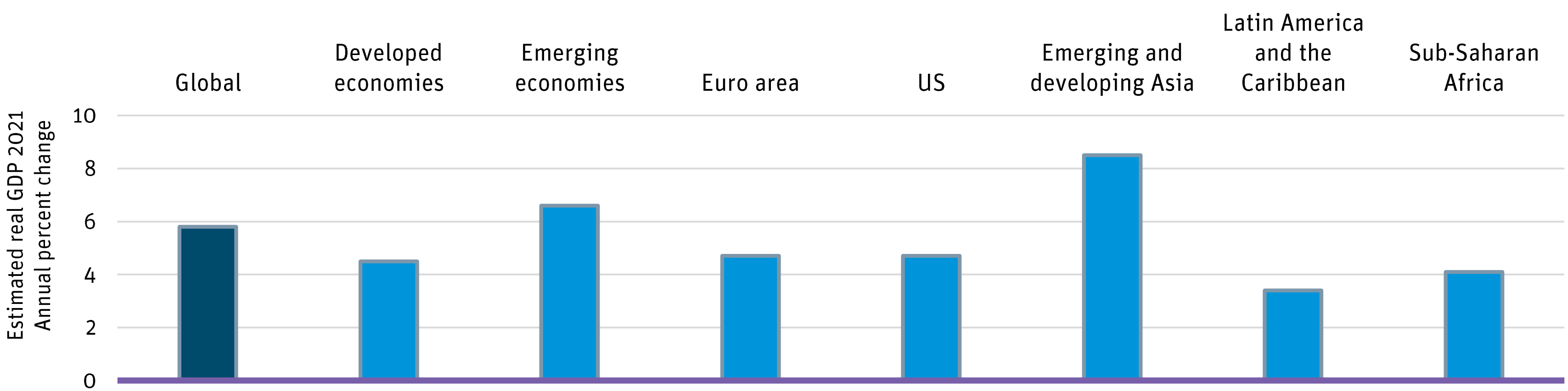
Global Economy

Global Economy: MMXXI _ anticipated rebound

A large swath of the global economy is projected to experience an output contraction in 2020…



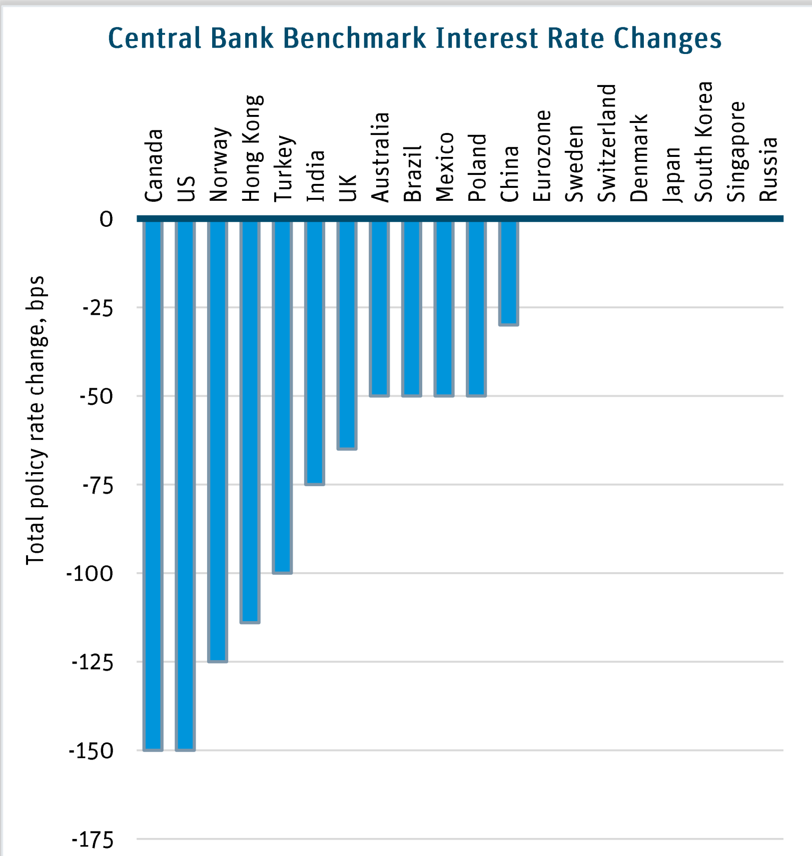
…before a strong anticipated rebound in 2021, led by emerging economies in Asia.



Source: International Monetary Fund. Data as of 4/14/2020.

Monetary Policy: Central banks have been pushed from the sidelines into action

Interest rates have been cut since January 2020…



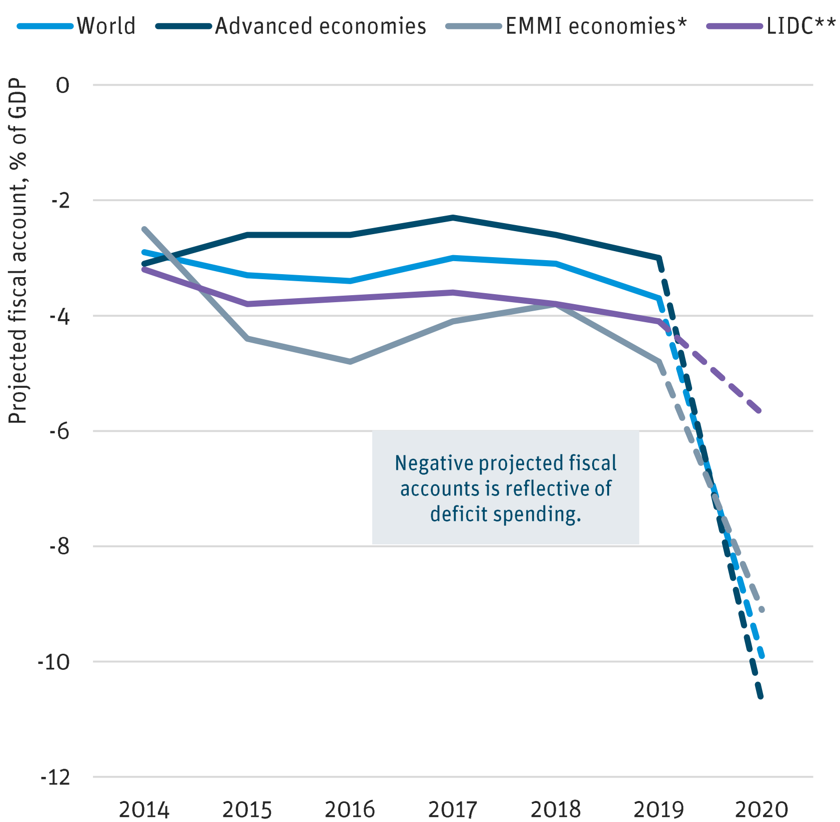
…and quantitative easing, liquidity and lending programs implemented.

	Asset Purchases	Liquidity Support	State Loans/Credit Guarantees
Canada	Y	Y	Y
US	Y	Y	Y
Norway	N	Y	Y
Hong Kong	N	Y	Y
Turkey	N	Y	N
India	N	Y	N
UK	Y	Y	Y
Australia	Y	Y	Y
Brazil	N	Y	N
Mexico	N	Y	N
Poland	Y	Y	N
China	N	Y	Y
Eurozone	Y	Y	Y
Sweden	Y	Y	Y
Switzerland	N	Y	Y
Denmark	N	Y	N
Japan	Y	Y	Y
South Korea	N	Y	Y
Singapore	N	Y	Y

Source: International Monetary Fund. Data as of 4/14/2020.

Fiscal Policy: Low interest rates will help finance rising government expenditures

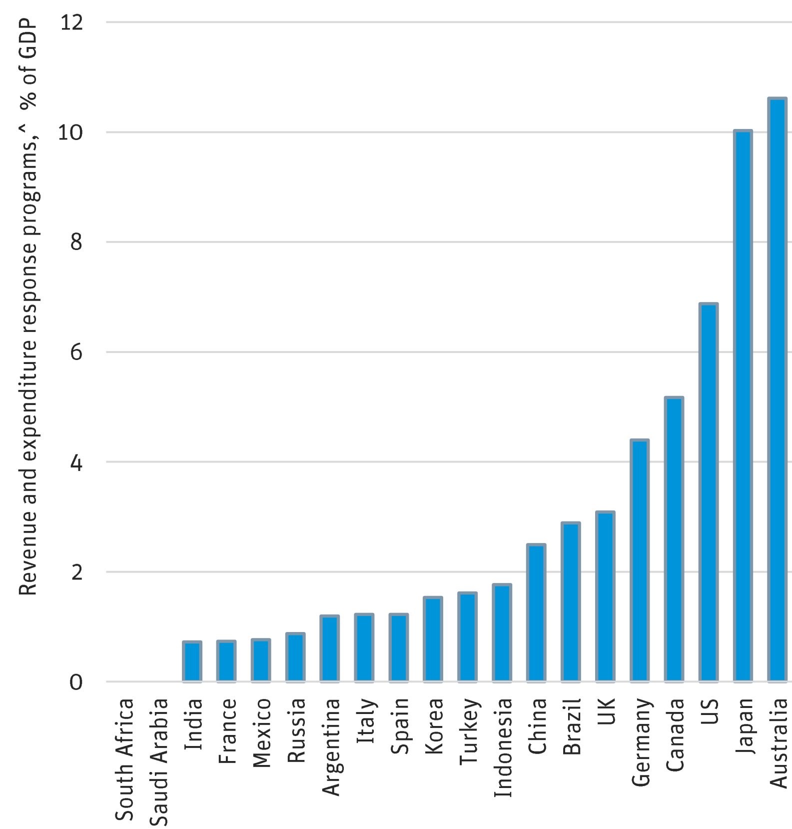
Government Stimulus Spending Anticipated Across Major Economies



*Emerging markets and middle-income economies
**Low-income developing countries

Response Spending Tally Likely To Grow

Estimate of fiscal stimulus announced as of April 8, 2020.



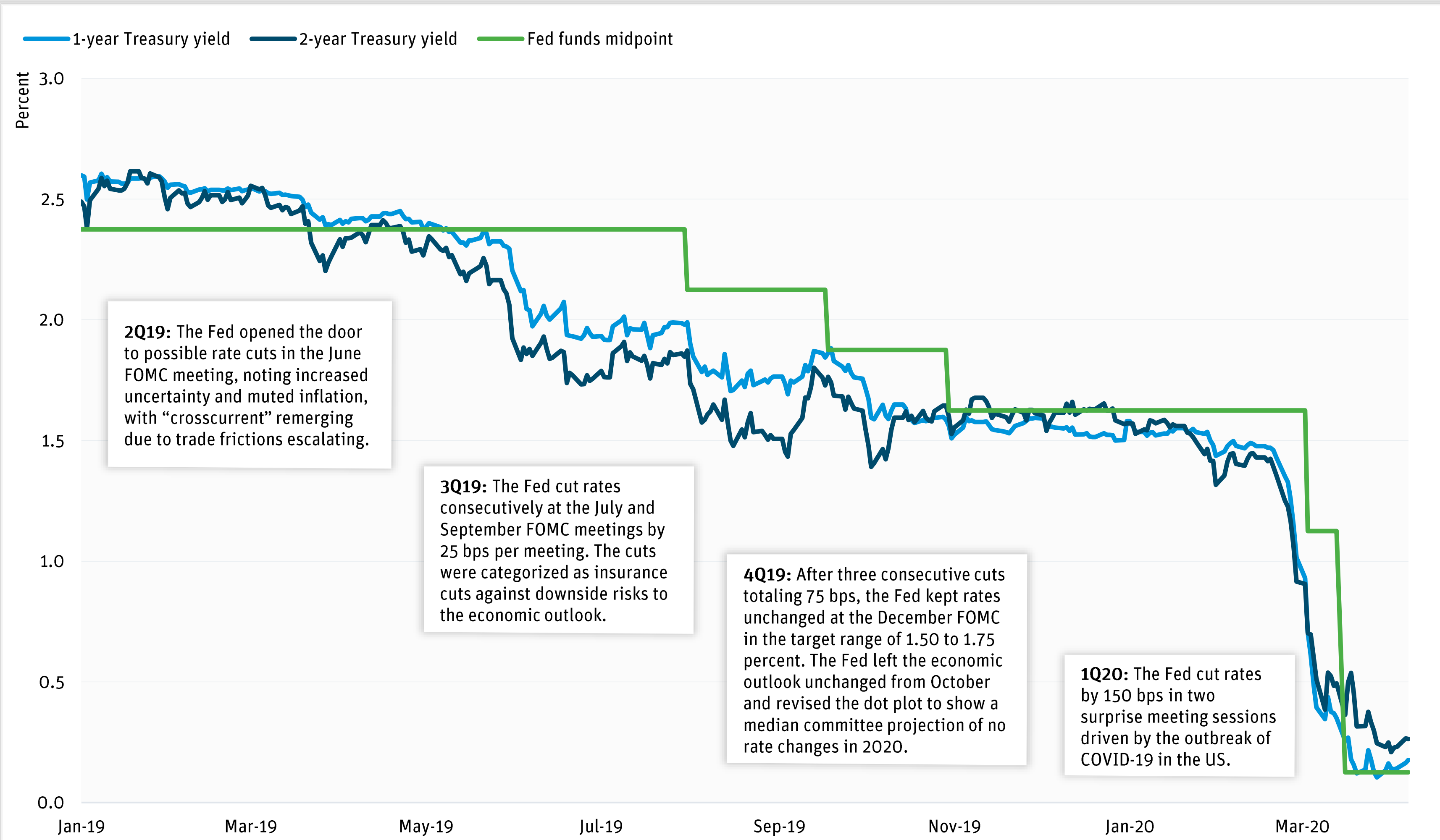
^G20 countries. Based on IMF staff estimates as of 4/8/2020.

Source: International Monetary Fund. Data as of 4/14/2020.

Central Banks

Historical Interest Rates

The Fed cut the fed funds rate to zero in two surprise meetings in March, along with implementing the "alphabet soup" of liquidity facilities.



Sources: Bloomberg and SVB Asset Management. Data as of 4/8/2020.

Federal Reserve Board Establishes Emergency Facilities

Facility	Summary	Size
Treasury and Mortgage-backed Securities (MBS) Asset Purchases	Purchase Treasuries, agency MBS, agency commercial MBS	Unlimited
Commercial Paper Funding Facility (CPFF)	Purchase commercial paper directly from issuers	$10 billion Treasury protection
Primary Dealer Credit Facility (PDCF)	Dealers can borrow cash by pledging collateral	TBD
Money Market Mutual Fund Liquidity Facility (MMLF)	Provides loans to dealers for purchasing securities from prime funds	TBD
Primary Market Corporate Credit Facility (PMCCF)	Purchase corporate bonds from eligible issuers	$750 billion (combined total with SMCCF)
Secondary Market Corporate Credit Facility (SMCCF)	Purchase corporate bonds and exchange-traded funds (ETFs)	$750 billion (combined total with PMCCF)
Term Asset-Backed Securities Loan Facility (TALF)	Provides loans to companies collateralized with new issue asset-backed securities (ABS)	$100 billion
Foreign and International Monetary Authorities (FIMA) Repo Facility	Repo facility which will accept Treasuries from eligible authorities	TBD
Small Business Administration's Paycheck Protection Program (PPP)	Provides loans collateralized by PPP loans by the Small Business Administration (SBA)	$350 billion
Municipal Liquidity Facility	Purchase munis from eligible states, counties and cities	$500 billion
Main Street Lending Programs	Provide funding to banks in order to make loans to small and medium sized businesses	$600 billion Combined three facilities: Main Street New Loan Facility (MSNLF), Main Street Expanded Loan Facility (MSELF), Main Street Priority Loan Facility (MSPLF)

Sources: Federal Reserve and SVB Asset Management as of 4/30/2020.

Central Bank Economic Projections

Global growth has moderated though employment has remained strong and synchronous, while inflation has remained relatively subdued.

Economic Projections	2020	2021	2022
United States			
Change in real GDP	2.0%	1.9%	1.8%
Core PCE inflation	1.9%	2.0%	2.0%
Unemployment rate	3.5%	3.6%	3.7%
United Kingdom			
Change in real GDP	0.4%	1.4%	1.6%
CPI inflation	1.8%	1.5%	2.0%
Unemployment rate	3.8%	3.9%	3.7%
Eurozone			
Change in real GDP	1.1%	1.4%	1.4%
CPI inflation	1.2%	1.0%	1.5%
Unemployment rate	7.4%	7.2%	7.1%
Japan			
Change in real GDP	0.9%	1.1%	N/A
Core CPI inflation	1.0%	1.4%	N/A

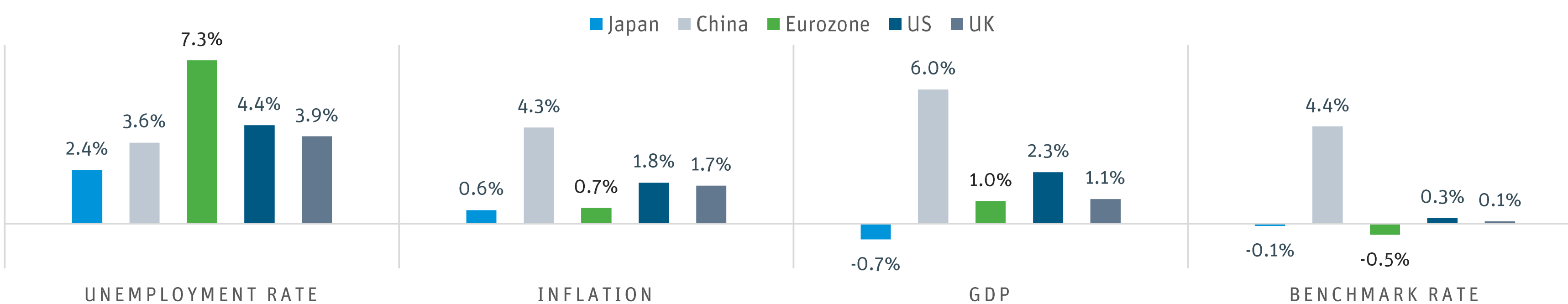
Sources: Federal Reserve, European Central Bank, Bank of Japan and Bank of England. Per National People's Congress of China, this data is not applicable for China. Data as of 12/11/2019. Forecasts are not available for all periods.

Central Banks: Activating afterburners

In response to COVID-19 becoming a global pandemic, major central banks abruptly moved from the sidelines into a full sprint to fight against the economic disruptions caused by the coronavirus.

	Japan	China	Eurozone	US	UK
	Easing				Steady
Current Monetary Policy	• Policy rate: -0.1% • Ten-year JGB target rate: 0% • QE annual purchases: ¥80 trillion JGB ¥12 trillion ETF ¥180 trillion J-REIT	• Deposit rate: 1.5% • Lending rate: 4.35% • Loan prime rate: 4.05% • 1-year medium term lending rate: 3.15% • Reserve requirement ratio (RRR): 12.5%	• Refinancing rate: 0% • Marginal lending facility: 0.25% • Deposit facility: -0.5% • QE: €20 billion/month; additional €120 billion total through 2020	• Fed funds target range: 0% to 0.25% • Interest on excess reserves: 0.10% • QE: No limit	• Bank rate: 0.10% • QE: Buying £200B in gilts and corporate debt
Analysis	Intensified QE in March with increased purchases of corporate debt and equities. Boosted liquidity with corporate debt backed loans and increased US dollar availability.	PBOC has taken moderate action, including 50 to 100 bps reserve ratio cuts for certain banks and expanding loan facilities and loan forbearance for certain industries.	ECB eased through 25 bps cut to TLTRO rate, unlimited LTRO at negative 50 bps and implementing a €750 billion separate bond buying program.	Fed established a number of credit support programs, including financing of certain corporate bonds, ABS, commercial paper, SME loans and money market instruments.	Added term funding program, eliminated bank countercyclical capital buffer, expanded repo operations and increased US dollar availability.

SNAPSHOT OF Q1 ECONOMIC DATA



Sources: Bank of Japan, People's Bank of China, European Central Bank, Bank of England, Federal Reserve Bank and Bloomberg. Data as of 4/8/2020.

Markets and Performance

Broad Market Performance: "Risk-off mode"

US markets were in "risk-off mode" as the coronavirus pandemic hits the global financial markets. This was exacerbated by breakdowns in negotiations between OPEC and Russia adversely affecting the oil, equities and high-yield sectors.

Asset class returns

2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020 YTD
Gold 29.67%	Gold 10.23%	REIT 16.47%	Wilshire 33.06%	REIT 28.24%	S&P 500 1.40%	Crude Oil 44.80%	S&P 500 21.80%	**US Treasuries 0.86%**	Crude Oil 35.28%	**US Treasuries 8.20%**
REIT 26.97%	**US Treasuries 9.81%**	Wilshire 16.05%	S&P 500 32.39%	S&P 500 13.69%	REIT 1.30%	**US High Yield 17.13%**	Wilshire 21.00%	**US Aggregate 0.01%**	S&P 500 31.49%	Gold 4.83%
Wilshire 17.18%	**US IG Corp 8.15%**	S&P 500 16.00%	**US High Yield 7.44%**	Wilshire 12.70%	**US Treasuries 0.84%**	Wilshire 13.40%	Gold 13.70%	**US High Yield -2.08%**	Wilshire 31.02%	**US Aggregate 3.15%**
US High Yield 15.12%	Crude Oil 8.15%	**US High Yield 15.81%**	Crude Oil 7.32%	**US IG Corp 7.46%**	Wilshire 0.70%	S&P 500 12.00%	Crude Oil 12.50%	Gold -2.10%	REIT 24.33%	**US IG Corp -3.63%**
Crude Oil 15.10%	**US Aggregate 7.84%**	**US IG Corp 9.82%**	REIT 1.26%	**US Aggregate 5.97%**	**US Aggregate 0.55%**	Gold 8.60%	**US High Yield 7.50%**	**US IG Corp -2.51%**	Gold 18.87%	**US High Yield -12.68%**
S&P 500 15.06%	REIT 7.48%	Gold 6.96%	**US IG Corp -1.53%**	**US Treasuries 5.05%**	**US IG Corp -0.68%**	REIT 7.10%	**US IG Corp 6.42%**	S&P 500 -4.40%	**US IG Corp 14.54%**	S&P 500 -19.60%
US IG Corp 9.00%	**US High Yield 4.98%**	**US Aggregate 4.21%**	**US Aggregate -2.02%**	**US High Yield 2.45%**	**US High Yield -4.47%**	**US IG Corp 6.11%**	REIT 3.70%	Wilshire -5.30%	**US High Yield 14.32%**	Wilshire -20.70%
US Treasuries 5.87%	S&P 500 2.11%	**US Treasuries 1.99%**	**US Treasuries -2.75%**	Gold -1.51%	Gold -10.50%	**US Aggregate 2.65%**	**US Aggregate 3.54%**	REIT -5.80%	**US Aggregate 8.72%**	REIT -27.24%
US Aggregate 6.54%	Wilshire 0.98%	Crude Oil -7.08%	Gold -28.26%	Crude Oil -45.76%	Crude Oil -30.50%	**US Treasuries 1.04%**	**US Treasuries 2.31%**	Crude Oil -25.30%	**US Treasuries 6.86%**	Crude Oil -66.47%

All returns above are on a total return basis. YTD 2020 returns are on an aggregate basis up to 3/31/2020. US Aggregate refers to Bloomberg Barclays Aggregate Bond Index; US Treasuries refers to the US Treasury allocation of the Bloomberg Barclays Aggregate Bond Index; US IG Corps refers to the Investment Grade Corporate allocation of the Bloomberg Barclays Aggregate Bond Index; US High Yield refers to Bloomberg Barclays US High Yield Index; Gold refers to S&P GSCI Gold Index Spot; Crude Oil refers to Spot West Texas Intermediate Crude Oil; Wilshire refers to Wilshire 5000 Total Market Index; REIT refers to MSCI US REIT Index; S&P 500 refers to S&P 500 Index.

Sources: Thomson Reuters and Bloomberg Barclays indices.
Past index performance is no guarantee of future results.

Fixed Income Returns

A swift shutdown in economic activity due to COVID-19 sent credit spreads and yields to the widest and highest levels since 2008–09. US government securities benefitted from the "flight to quality" while US corporates and consumer asset-backed securities (ABS) posted negative returns due to the spread widening.

		Current Duration	Current Yield %	Annual Total Return %		Non-annualized Periodic Total Return %				
				*2020**	2019	Q120	Q419	Q319	Q219	Q119
US Aggregate Index	**US Treasuries**	7.02	0.58	*37.06*	6.86	8.20	-0.79	2.40	3.01	2.11
	US Agencies	3.93	1.07	*17.62*	5.89	4.14	-0.09	1.74	2.32	1.81
	Corporates	7.98	3.44	*-13.75*	14.54	-3.63	1.18	3.05	4.48	5.14
	US MBS	1.67	1.34	*11.77*	6.35	2.82	0.71	1.37	1.96	2.17
	US ABS	2.07	2.40	*-0.84*	4.53	-0.21	0.39	0.92	1.67	1.48
	US CMBS	5.31	2.37	*4.85*	8.29	1.19	-0.33	1.89	3.28	3.24
US Short Duration	**1-3 Year US Treasuries**	1.89	0.26	*11.51*	3.59	2.76	0.51	0.58	1.47	0.99
	1-3 Year US Agencies	1.49	0.79	*8.03*	3.58	1.95	0.55	0.66	1.32	1.01
	1-3 Year Corporates	1.83	2.93	*-5.98*	5.30	-1.53	0.86	0.96	1.55	1.83
	<1 Year Corporates	0.49	3.10	*-0.44*	3.09	-0.11	0.58	0.68	0.85	0.94
	AAA Credit Card ABS	2.41	1.97	*1.73*	4.63	0.43	0.27	1.02	1.78	1.49
	AAA Auto ABS	1.77	2.34	*-0.68*	4.21	-0.17	0.48	0.77	1.50	1.39

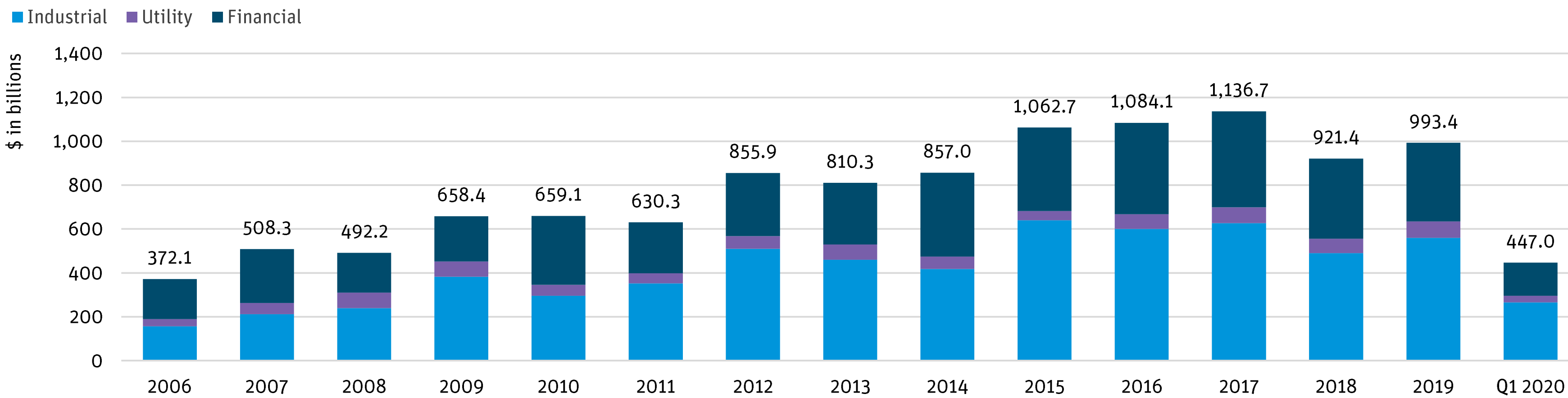
*Annualized periodic return data

Sources: Bloomberg Barclays indices. Data as of 3/31/2020. Heatmap colors based on periodic return percentage for time period shown. Past performance is not a guarantee of future results.

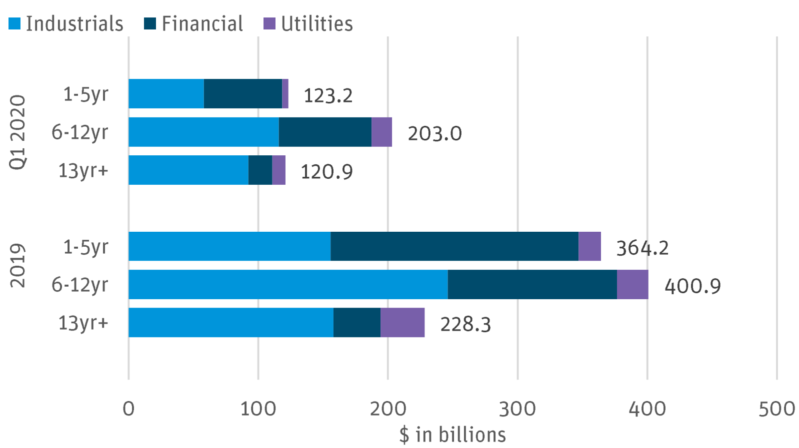
The New Issue Story

New issue volume in Q1 2020 for US investment-grade (IG) corporates was 45 percent of 2019 new issue volume. The majority of the IG issuers were able to secure term funding six years or longer in Q1 2020, with over 80 percent of the new issue supply coming from mid- to low investment-grade borrowers.

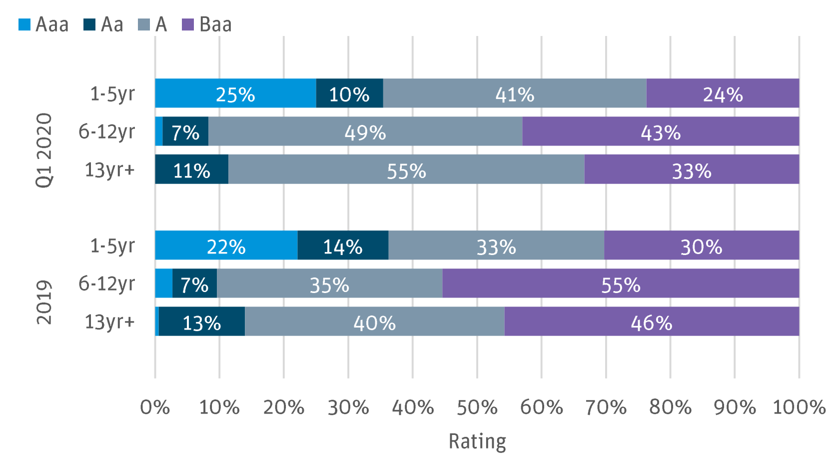
US IG Corporate New Issue Total Supply



IG Corporate New Issue Supply (Sector/Maturity)



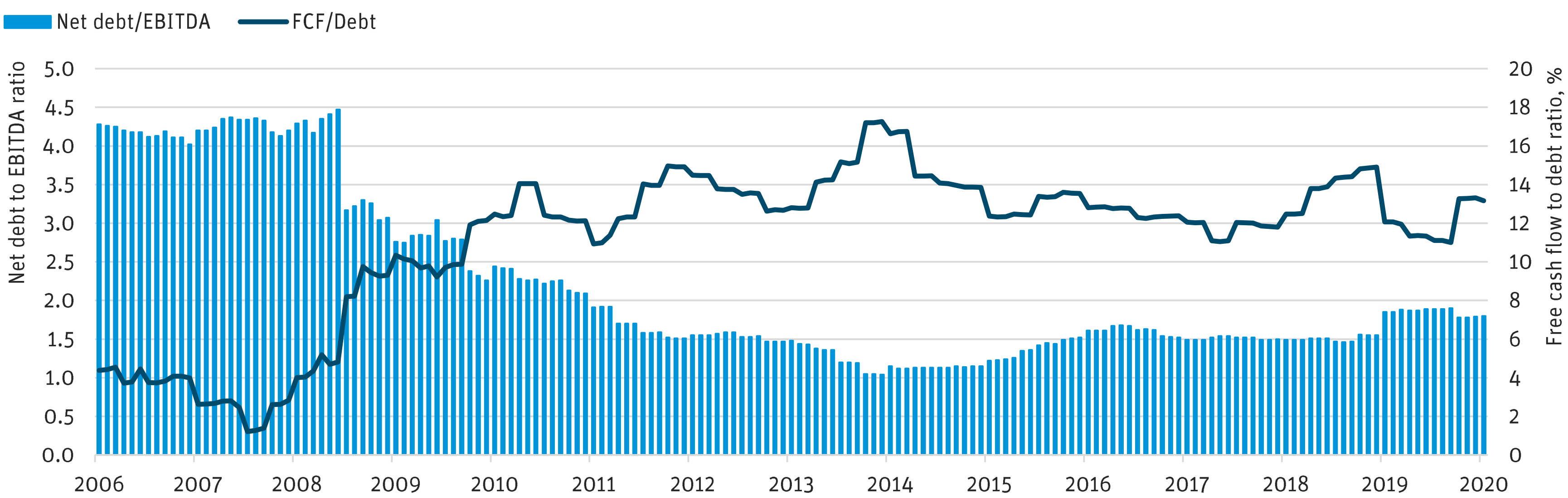
IG Corporate New Issue Supply (Rating/Maturity)



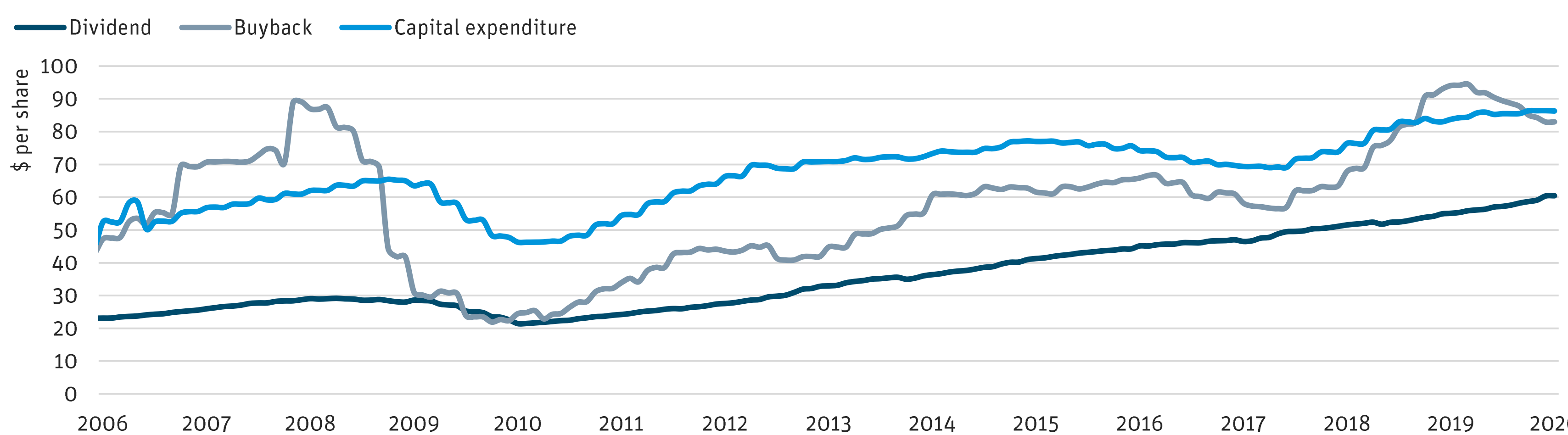
Sources: Bloomberg Barclays indices. Data as of 3/31/2020.
Past performance is not a guarantee of future results.

Corporates: Debt growth and corporate spending

S&P 500 Leverage and Debt Coverage



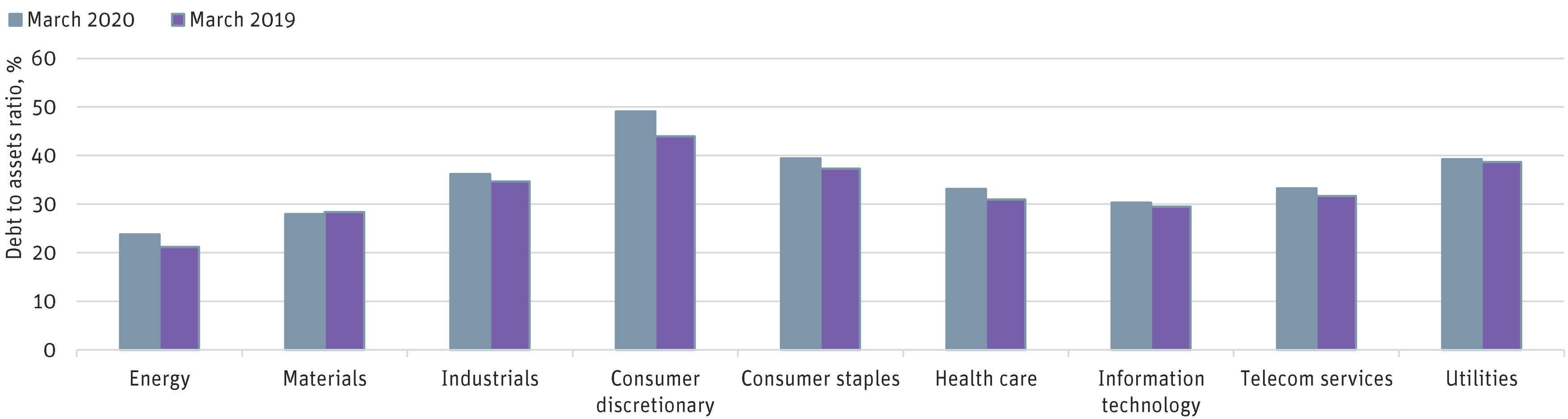
S&P 500 Capital Spending and Distribution



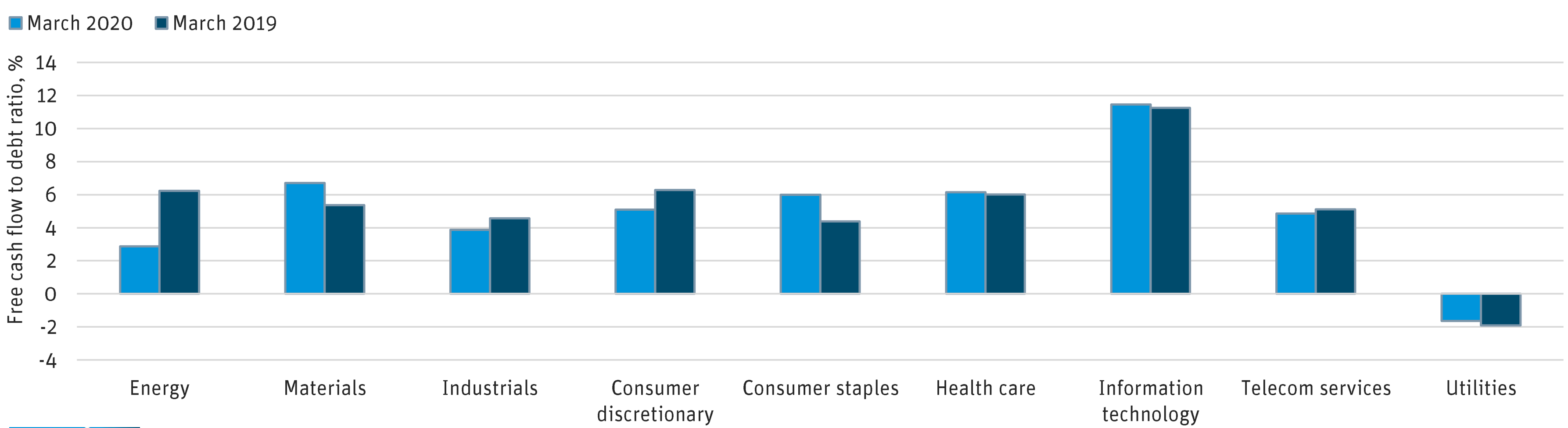
Source: Bloomberg. Data as of 3/31/2020.

Corporates: COVID-19 increasing debt load in most sectors

S&P 500 Debt to Assets (Ex-Financials)



S&P 500 Debt Coverage (Ex-Financials)

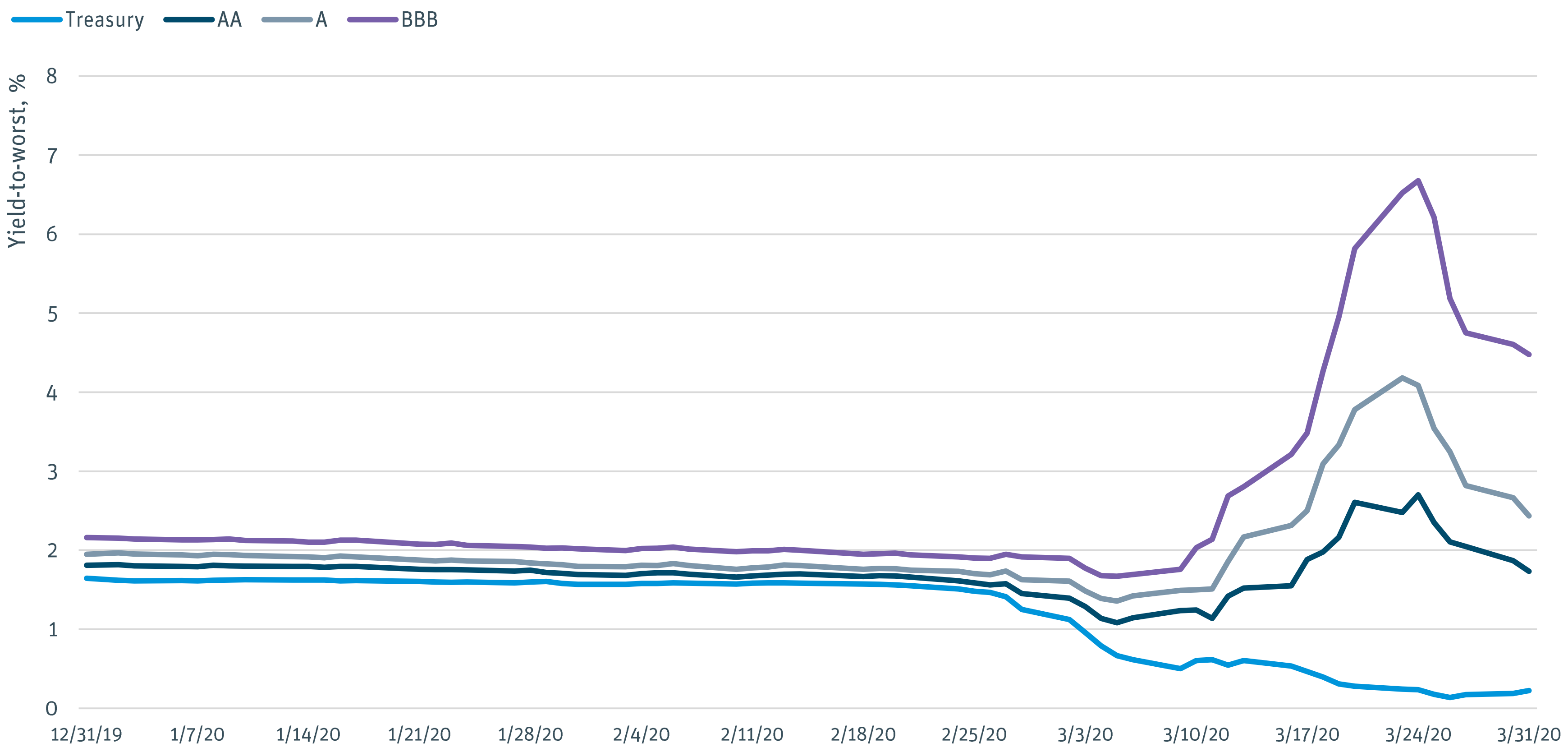


Source: Bloomberg. Data as of 3/31/2020.

Relative Value: Spread widening offering attractive yields

The majority of the spread widening was for BBB credits, while A and AA credits were offering attractive yields relative to comparable Treasury maturities.

Bloomberg Barclays Short-Term Indices (0- to 12- month maturities)

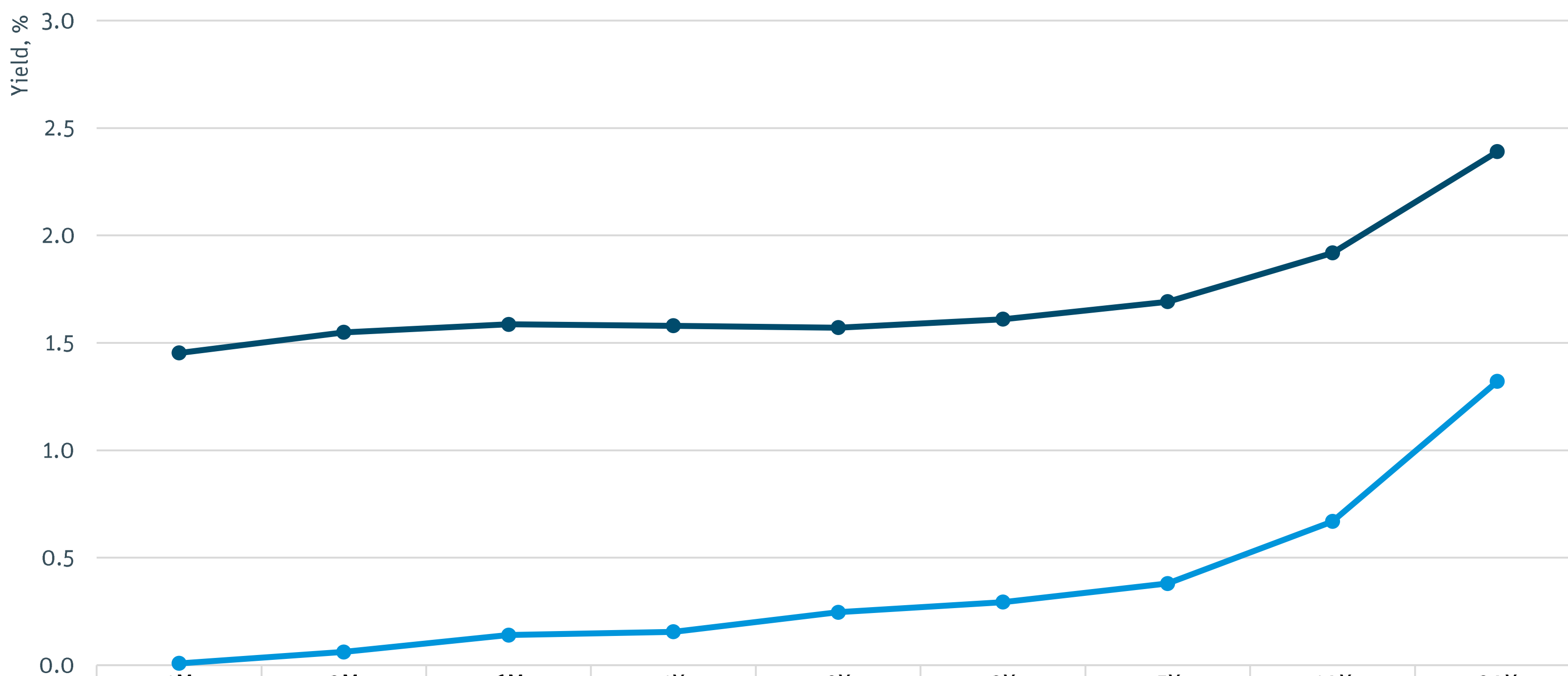


Source: SVB Asset Management and Bloomberg. Data as of 3/31/2020.
Past performance is not a guarantee of future results. The above is not to be construed as a recommendation for your particular portfolio.

2020 Yield Curve: Rate cuts leading to normalized curve

The yield curve was inverted for the majority of 2019. As the Fed has cut interest rates in 2020, the yield curve steepened but still remained relatively flat in the front end.

US Treasury Yields: On-the-run issues



	1M	3M	6M	1Y	2Y	3Y	5Y	10Y	30Y
3/31/2020	0.008	0.061	0.14	0.155	0.246	0.293	0.38	0.669	1.321
12/31/2019	1.453	1.549	1.586	1.58	1.571	1.61	1.692	1.919	2.39

Source: SVB Asset Management and Bloomberg. Data as of 3/31/20. Past performance is not a guarantee of future results. The above is not to be construed as a recommendation for your particular portfolio.

Our Team and Report Authors

Renuka Kumar, CFA
Head of SAM Portfolio Management
rkumar@svb.com

Eric Souza
Senior Portfolio Manager
esouza@svb.com

Jon Schwartz
Senior Portfolio Manager
jschwartz@svb.com

Jose Sevilla
Senior Portfolio Manager
jsevilla@svb.com

Paula Solanes
Senior Portfolio Manager
psolanes@svb.com

Jason Graveley
Senior Manager
Fixed Income Trading
jgraveley@svb.com

Hiroshi Ikemoto
Senior Fixed Income Trader
hikemoto@svb.com

Kevin Li
Fixed Income Trader
kli@svb.com

Fiona Nguyen
Senior Credit Risk & Research Officer
pnguyen@svb.com

Tim Lee, CFA
Senior Credit Risk & Research Officer
tlee@svb.com