svb Asset Management

Quarterly Economic Report

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

Q3 2020

Quarterly Economic Report

Published in Q3 2020 | Data for Q2 2020

Overview of Q2 2020

As we look back on the second quarter of 2020, we can see the constant push and pull of two opposing forces. As states entered various phases of re-opening, the economic green shoots became quite evident and even surprised to the upside. The employment outperformance started in May, when the unemployment rate was expected to worsen from 14.7 percent to 19 percent. The actual figures showed improvement in the rate to 13.3 percent, which continued progress in June to 11.1 percent. You could say that the only important thing to the Fed right now is jobs and the markets were encouraged to see unwavering strength in this area.

The consumer had a very strong quarter in terms of spending as evidenced by the surge in retail sales in the months of May and June. This rebound in spending from an abysmal March and April has been remarkable, but how much of this is on the back of inflated unemployment benefits, which expired in July? And let's not forget to mention the elephant in the room — COVID-19. We are seeing a significant resurgence in the virus, causing re-opening efforts to pause or reverse course for 80 percent of the country. The slowing of higher-risk activities (such as indoor dining) and increased social distancing are likely to have an effect on consumer behavior.

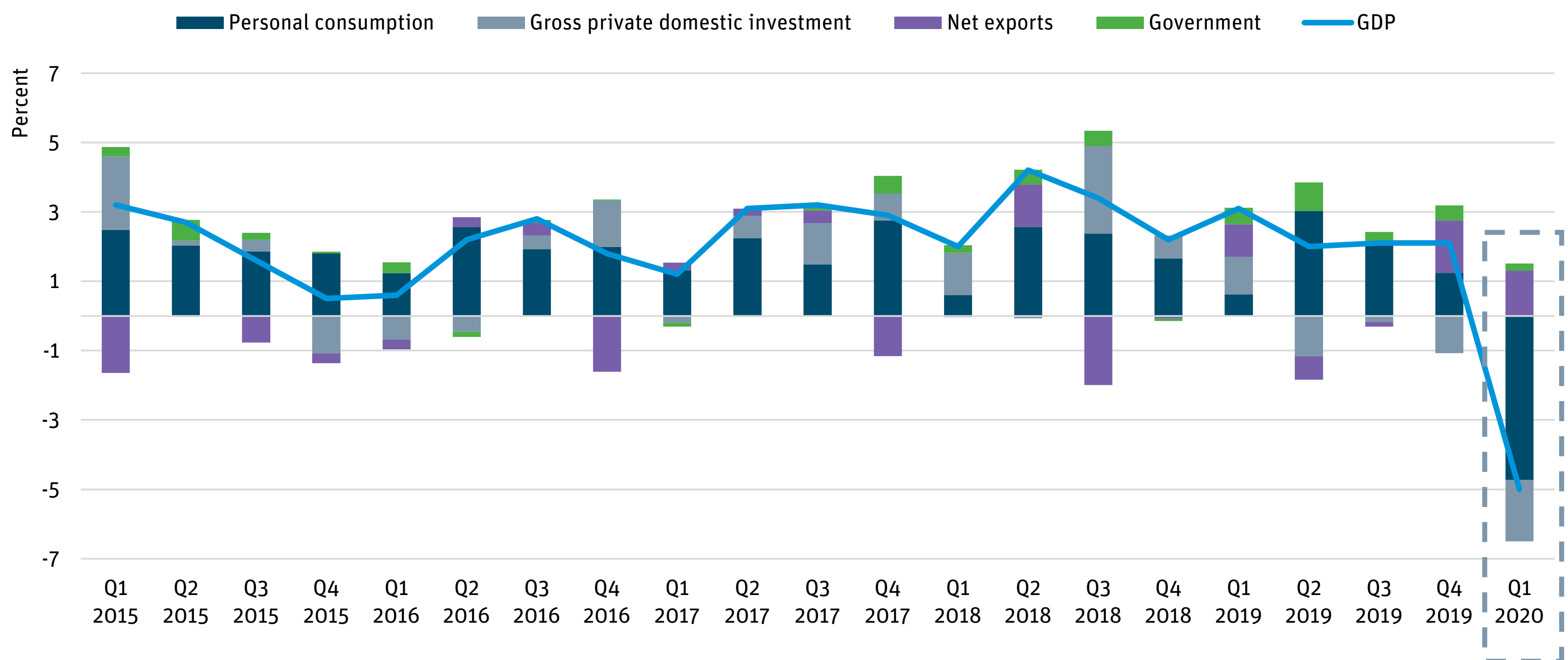
The Fed has committed to being the lender of last resort as it delivered a very clear message: "We're not even thinking about thinking about raising rates." The Fed reiterated its commitment to use its balance sheet to purchase US Treasuries, mortgage-backed securities, and even corporate bonds and commercial paper. These programs are underway, and they have been very successful at returning some normalcy to the markets. We still remain conservatively constructive on corporate credit and continue to add value for our clients during these challenging times.

Domestic Economy

GDP: Beginning of a recession

Q1 GDP showed that the US economy contracted by 5 percent, marking the beginning of a recession triggered by the global pandemic. In the last revision for Q1 GDP, the upward revision to nonresidential fixed investment was countered by revisions to private inventory — overall the revisions were muted. The most meaningful decrease to Q1 GDP came from personal consumption, with a 6.8 percent contraction. Q2 GDP is expected to see a significant contraction, given that it encompasses a longer period of shelter-in-place.

GDP and Components

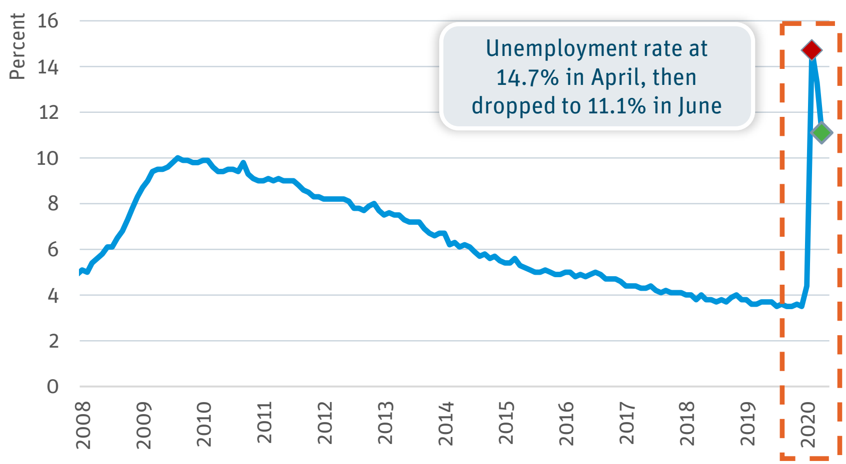


Sources: Bureau of Economic Analysis, Congressional Budget Office and SVB Asset Management. Data as of 7/3/2020. GDP values shown in legend are percent change vs. prior quarter on an annualized basis.

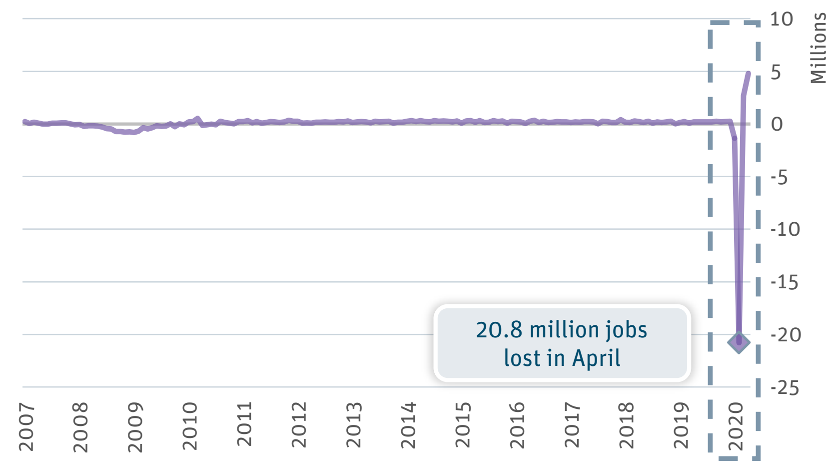
Employment: Reopening uncertainty looms

Almost 21 million jobs were lost in April, with close to a third regained in the subsequent two months. The unemployment rate peaked at 14.7 percent in April yet improved to 11.1 percent in June as lockdown requirements eased across the US. Despite the relatively quick recovery, uncertainty looms as the effects of the pandemic continue to weigh on businesses.

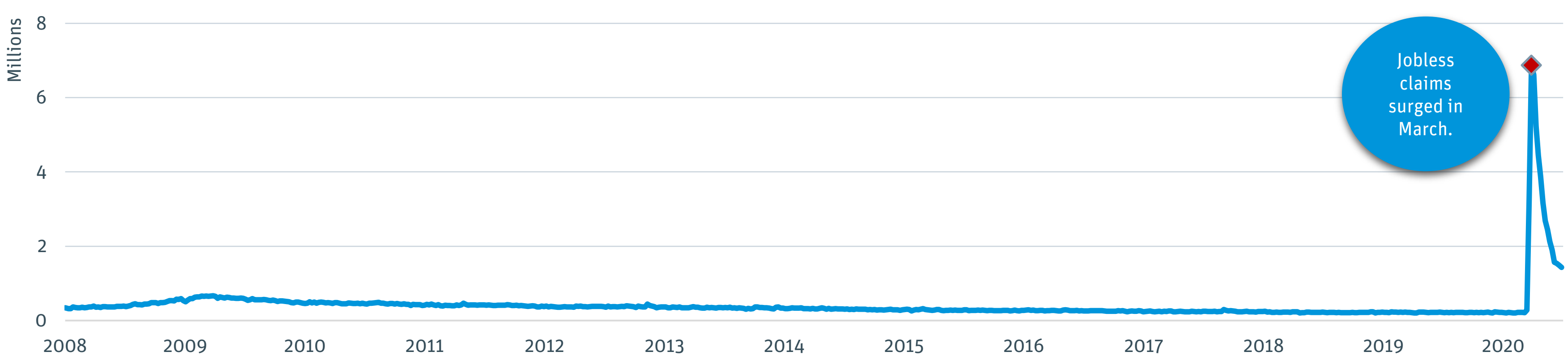
Unemployment Rate (%)



Nonfarm Payrolls (in millions)



Initial Jobless Claims: Glimpse of what's to come



Sources: US Bureau of Labor Statistics, Bloomberg and SVB Asset Management.
Data as of 7/3/2020.

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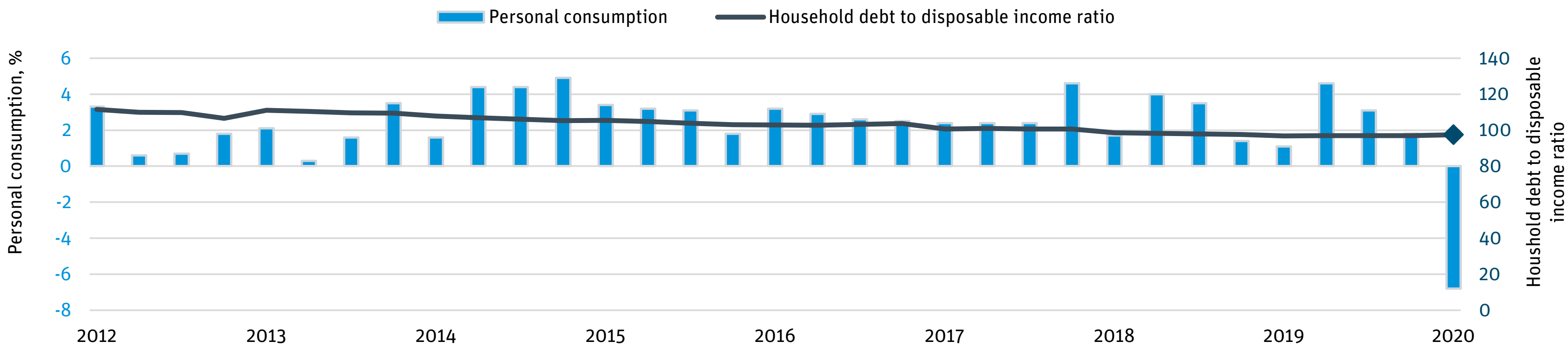
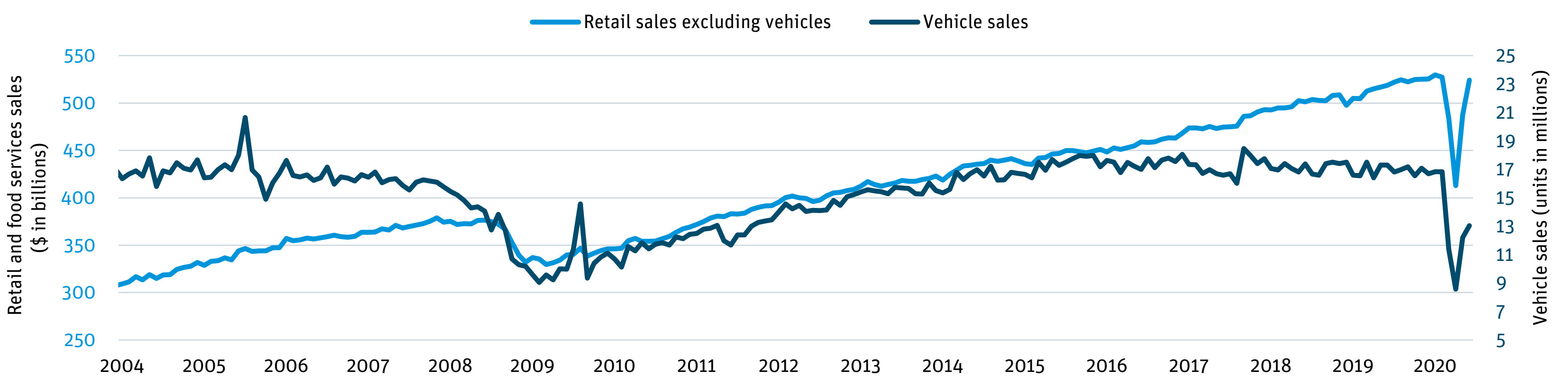
Consumption: Shift in spending habits

Consumption fell dramatically in Q1, however retail sales rebounded in June due in part to pent-up demand and fiscal stimulus. The pickup in retail spending in June showed a 105 percent increase in apparel and over a 30-percent increase in electronics and furniture on a month-over-month basis. While the recent data shows a V-shape recovery for retail, there is still a lot of uncertainty as to what the ultimate trends will look like.

Consumption Overview



Retail Sales

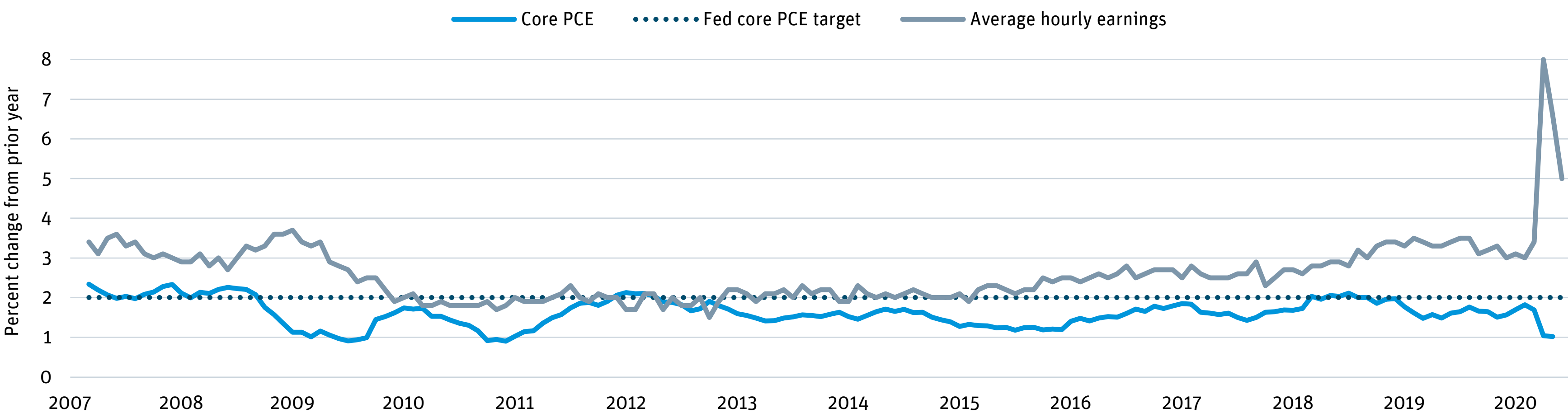


Sources: Bloomberg and SVB Asset Management. Data as of 7/3/2020.

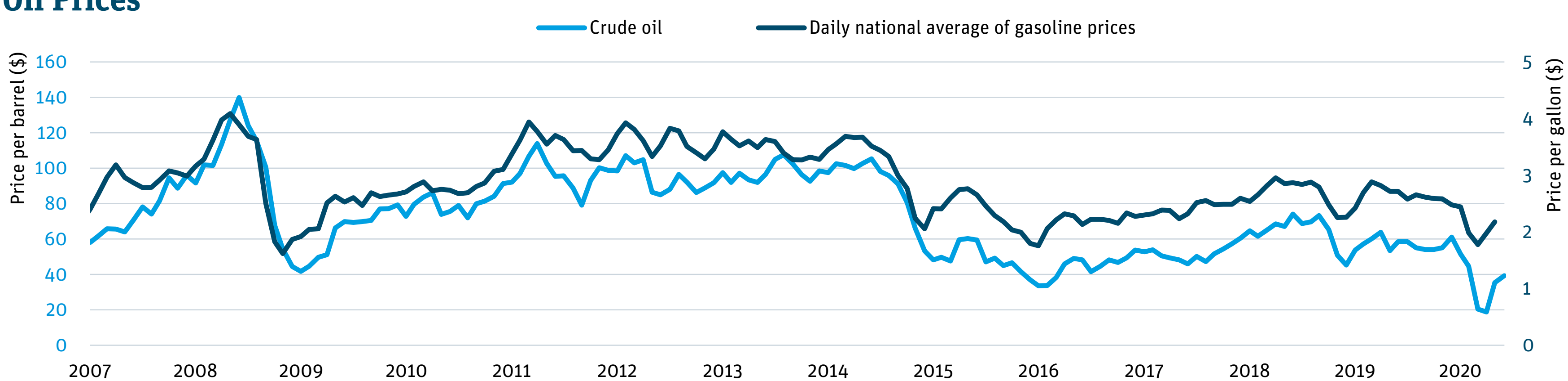
Inflation: Trending low

Inflation is expected to remain contained as demand stays centered around certain sectors while the economy works to regain normalcy. Oil prices have recovered from its lows as global suppliers have curtailed production to better align with demand expectations.

Core PCE



Oil Prices

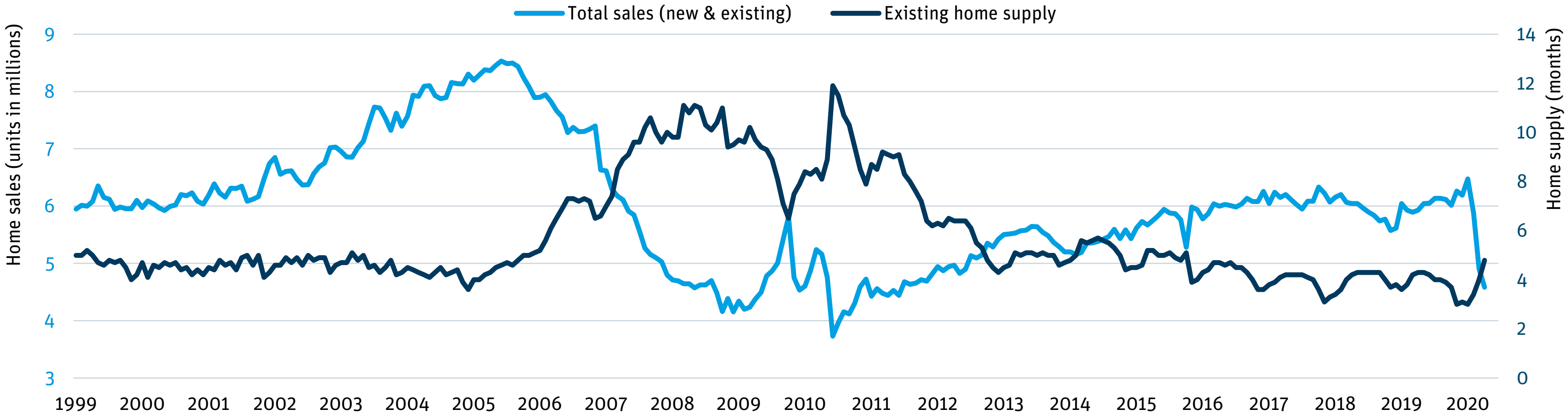


Sources: Bloomberg and SVB Asset Management. Data as of 7/3/2020.

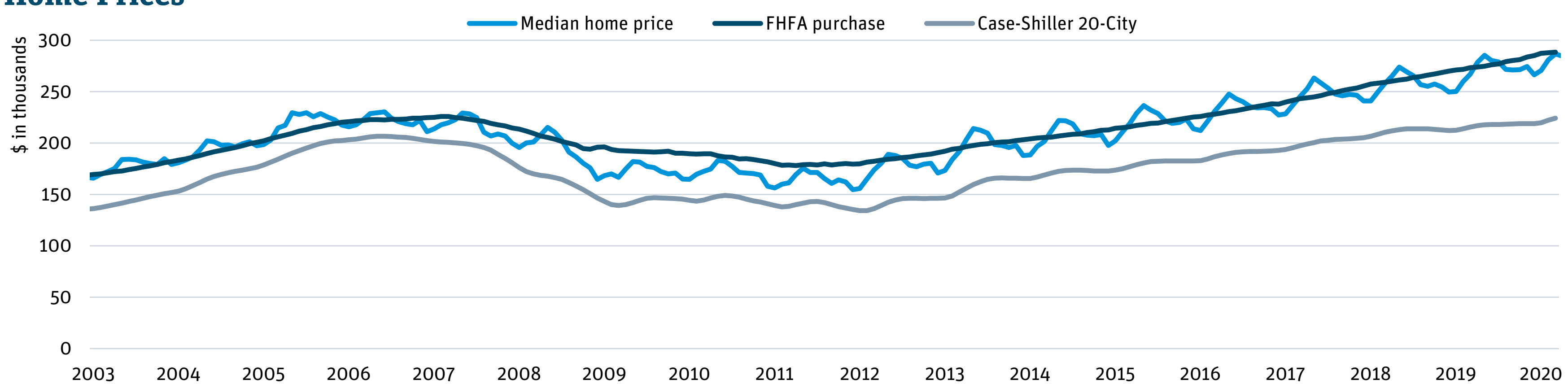
Housing: Decreased activity

Housing activity has fallen with increased economic and labor market uncertainty. In May, existing home sales fell 9.7 percent, the lowest level since 2010. Home prices continue to stay afloat; however, there may be downward pressure if the economic downturn persists or shelter-in-place mandates resume.

Housing Market



Home Prices

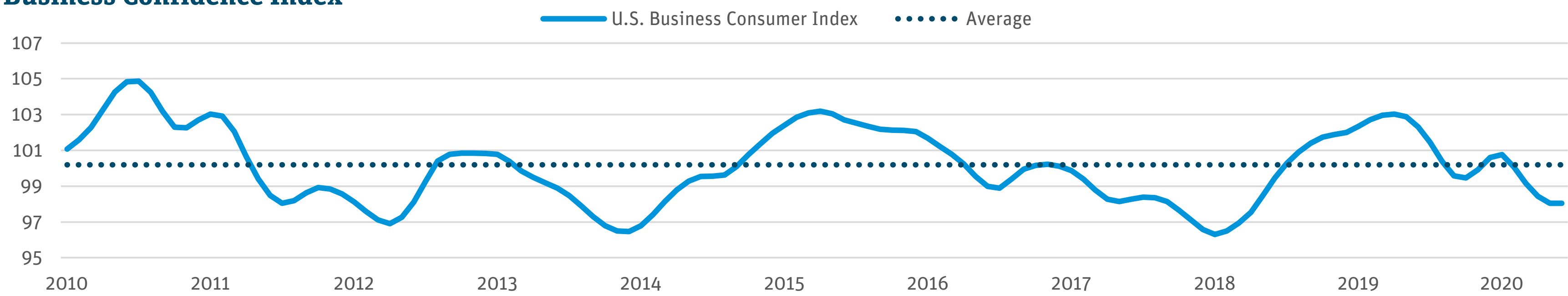


Sources: Bloomberg and SVB Asset Management. Data as of 7/3/2020.

Business Outlook: Uncertainty persists

Business sentiment has waned with the pandemic. However, Fed surveys show a relatively quick recovery in June. Given that economic activity hinges on managing the spread of the global pandemic, the second half of the year could slow down again.

Business Confidence Index



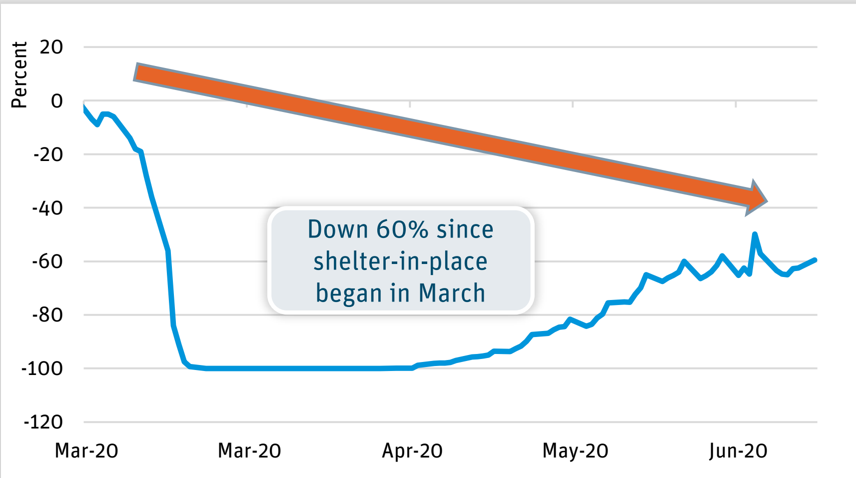
Business Sentiment

	Dallas Fed Manufacturing Survey	Philly Fed Manufacturing Survey	New York Fed's Empire Manufacturing Survey	Kansas City Fed Manfacturing Survey	Richmond Fed Manufacturing Survey	ISM Manufacturing PMI SA	ISM Non-Manufacturing
January-19	-0.2	17	3.9	5	-2	55.5	56
February-19	11.6	-4.1	8.8	1	16	54.1	58.5
March-19	6.9	13.7	3.7	10	10	54.6	56.3
April-19	2	8.5	10.1	5	3	53.4	55.7
May-19	-5.3	16.6	17.8	4	5	52.3	56.3
June-19	-12.1	0.3	-8.6	0	3	51.6	55.4
July-19	-6.3	21.8	4.3	-1	-12	51.3	54.8
August-19	2.7	16.8	4.8	-6	1	48.8	56
September-19	1.5	12	2	-2	-9	48.2	53.5
October-19	-5.1	5.6	4	-3	8	48.3	54.7
November-19	-1.3	10.4	2.9	-3	-1	48.1	53.9
December-19	-3.2	0.3	3.5	-8	-5	47.2	55
January-20	-0.2	17	4.8	-1	20	50.9	55.5
February-20	1.2	36.7	12.9	5	-2	50.1	57.3
March-20	-70.1	-12.7	-21.5	-17	2	49.1	52.5
April-20	-74	-56.6	-78.2	-30	-53	41.5	41.8
May-20	-49.2	-43.1	-48.5	-19	-27	43.1	45.4
June-20	-6.1	27.5	-0.2	1	0	52.6	57.1

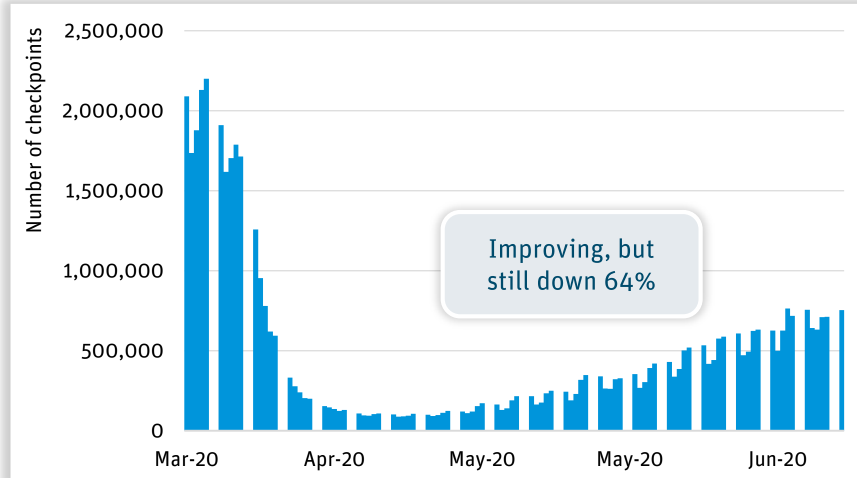
Sources: Bloomberg, OECD and Business Confidence Index (BCI) (indicator). DOI: 10.1787/3092dc4f-en (accessed on April 14, 2020). Heatmap colors based on the indices and time periods shown. Data as of 7/3/2020.

High-Frequency Data: Effects of COVID-19

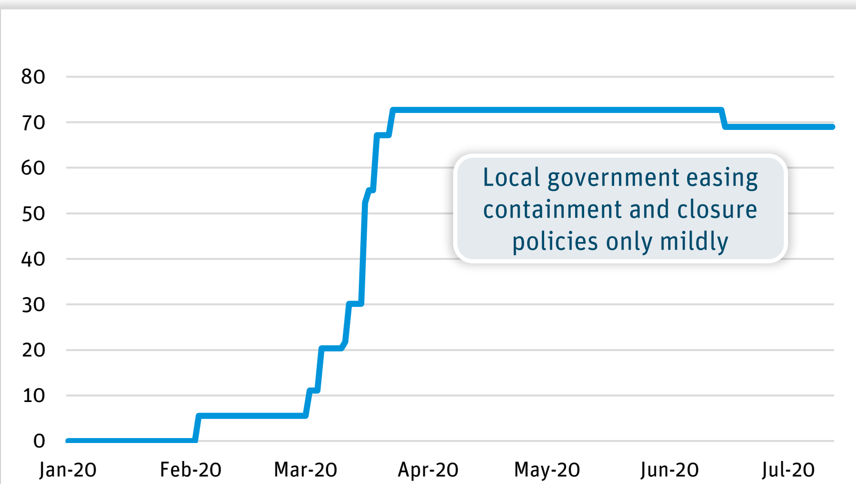
OpenTable Reservations



TSA Checkpoints

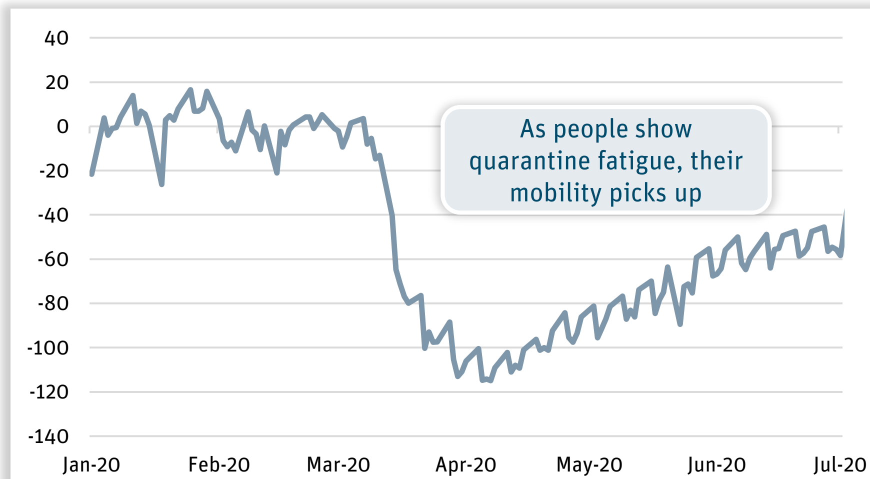


Stringency US Index



Dallas Fed Mobility and Engagement Index

(formerly known as the Social Distancing Index)



Sources: Bloomberg and SVB Asset Management. Data as of 7/13/2020.

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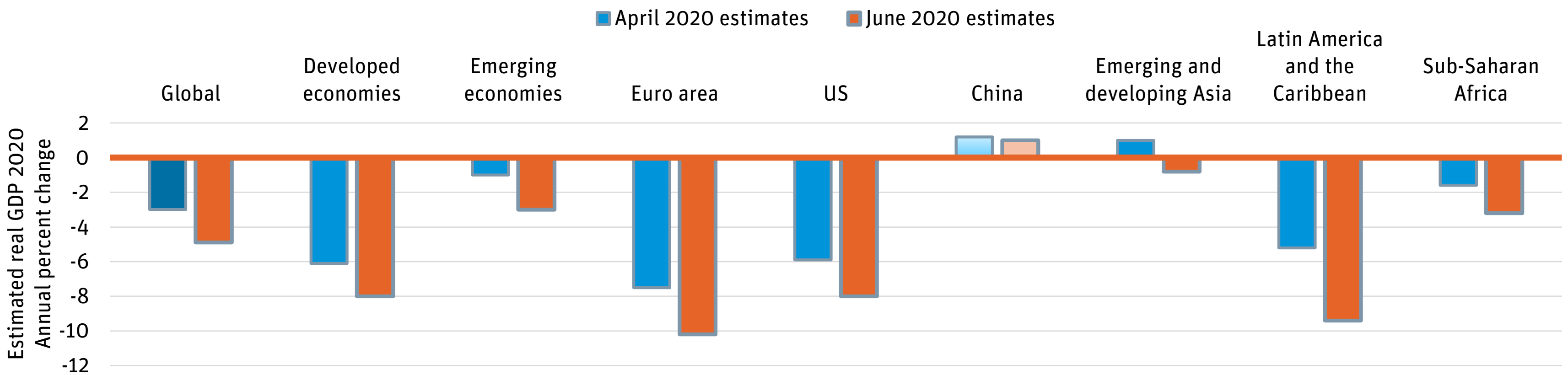
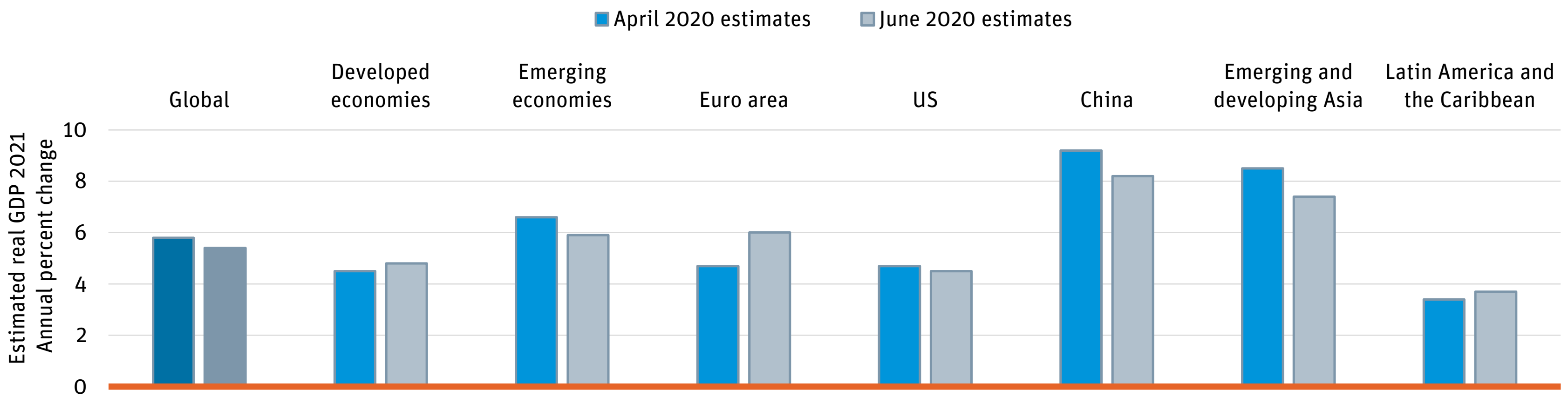
Global Economy

Global Economy: Deeper recession with a tempered recovery

Except for China, the global economy is projected to experience a sharper output contraction in 2020...



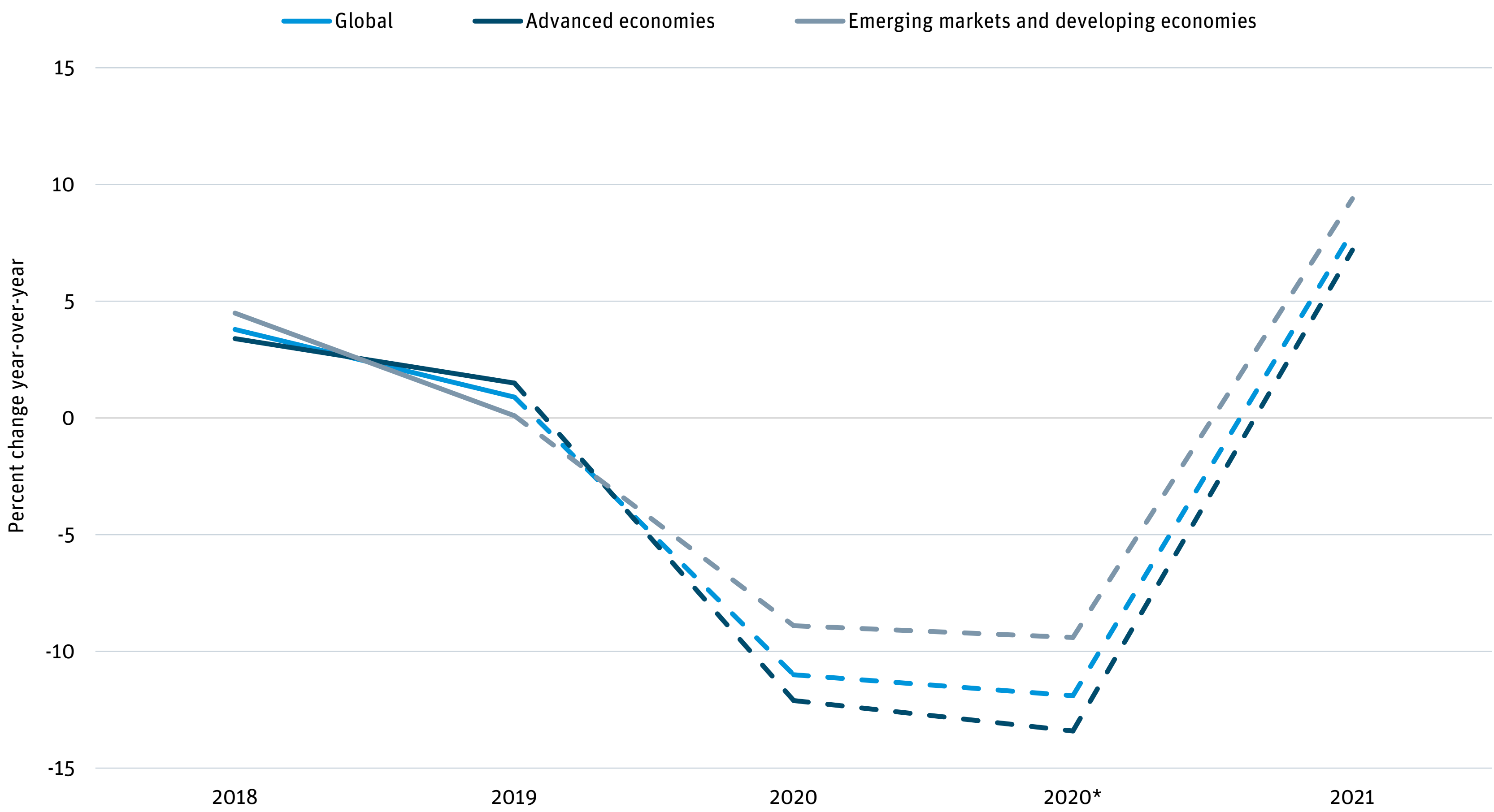
...before an anticipated rebound in 2021, led by emerging economies in Asia.



Source: International Monetary Fund. Data as of 6/24/2020.

World Trade Projected to Worsen Before Bouncing Back in 2021

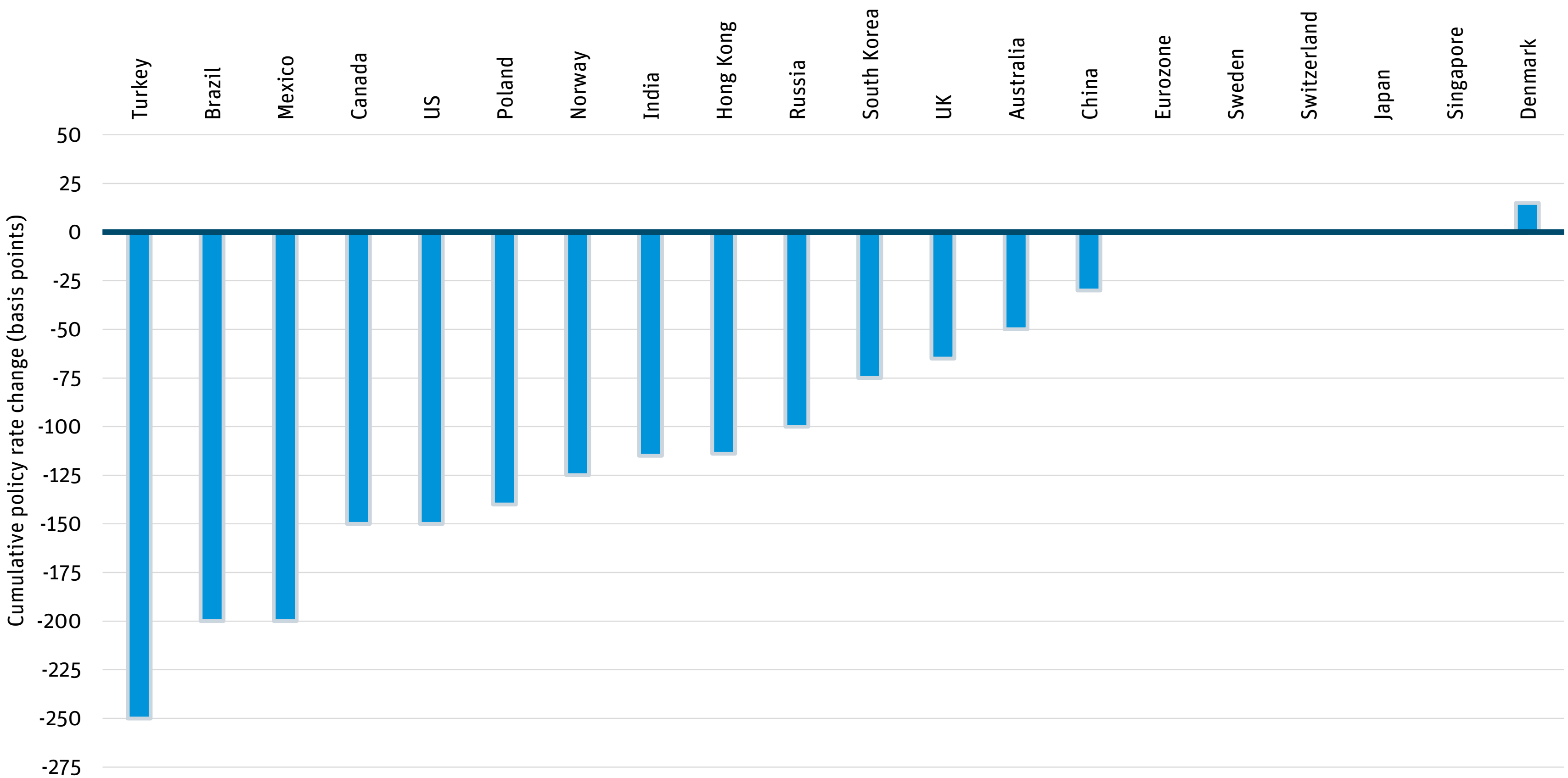
Goods and Services Trade Volume Change



Source: International Monetary Fund. Data as of 6/24/2020.
*Revised 2020 projection, June from April

Monetary Policy: More central banks join in on cutting rates

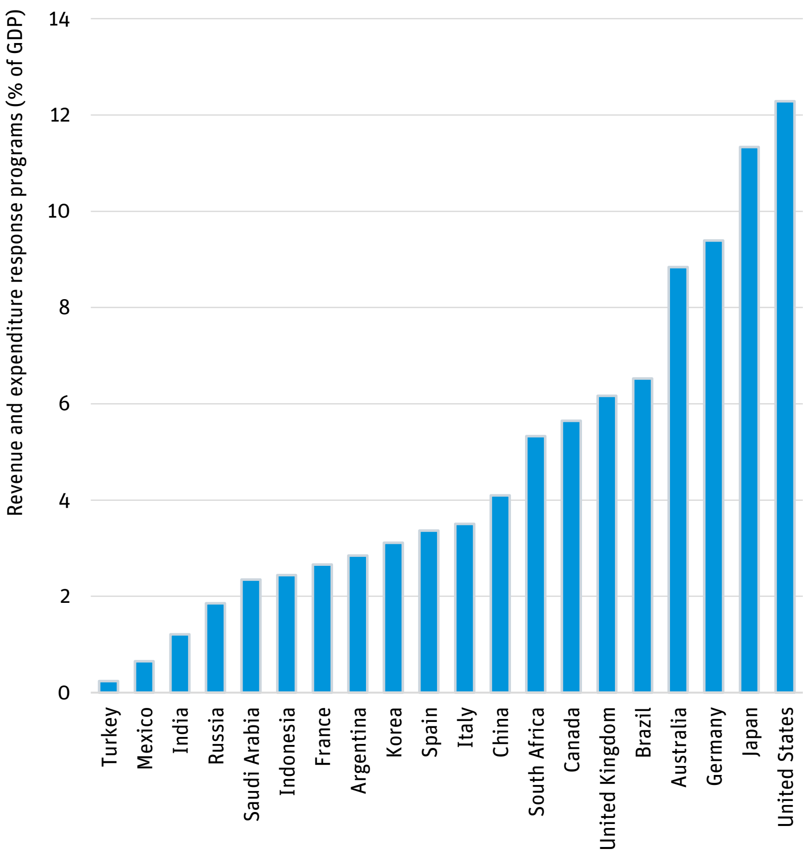
Total Central Bank Benchmark Interest Rate Changes Since January 2020



Sources: International Monetary Fund and Bloomberg. Data as of 7/10/2020.

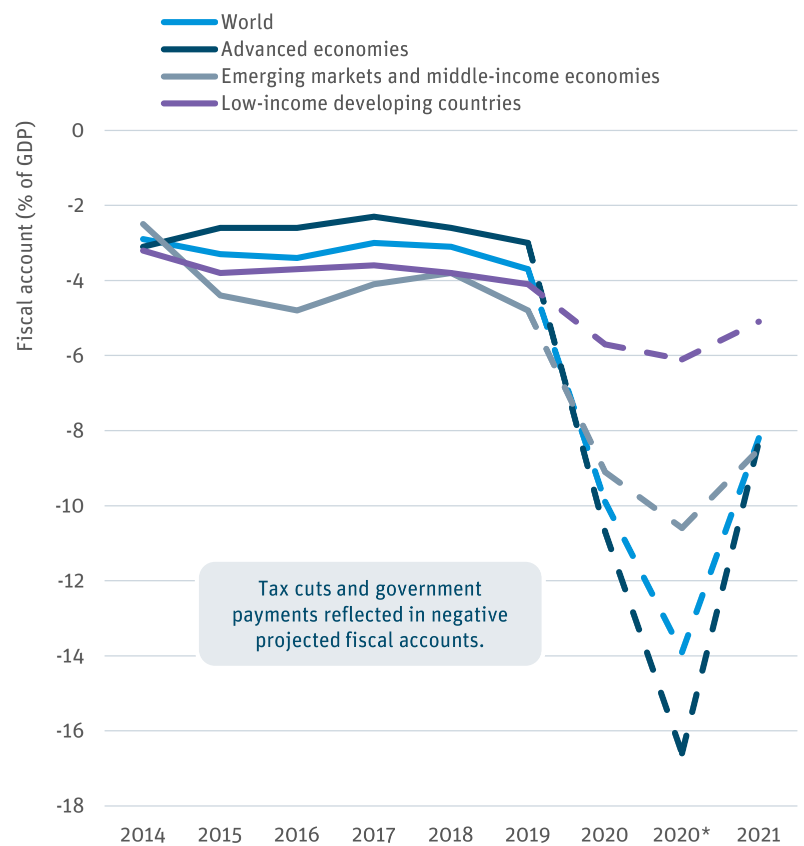
Fiscal Policy: Governments expand programs to spur demand

Government Support Programs Expanding Amid a Protracted Recovery



Note: G20 countries. Based on IMF staff estimates as of 6/12/2020.

Fiscal Stimulus Contributing to Deeper Fiscal Deficits



*2020 projection, April estimate revised in June.

Source: International Monetary Fund (IMF). Data as of 6/24/2020.

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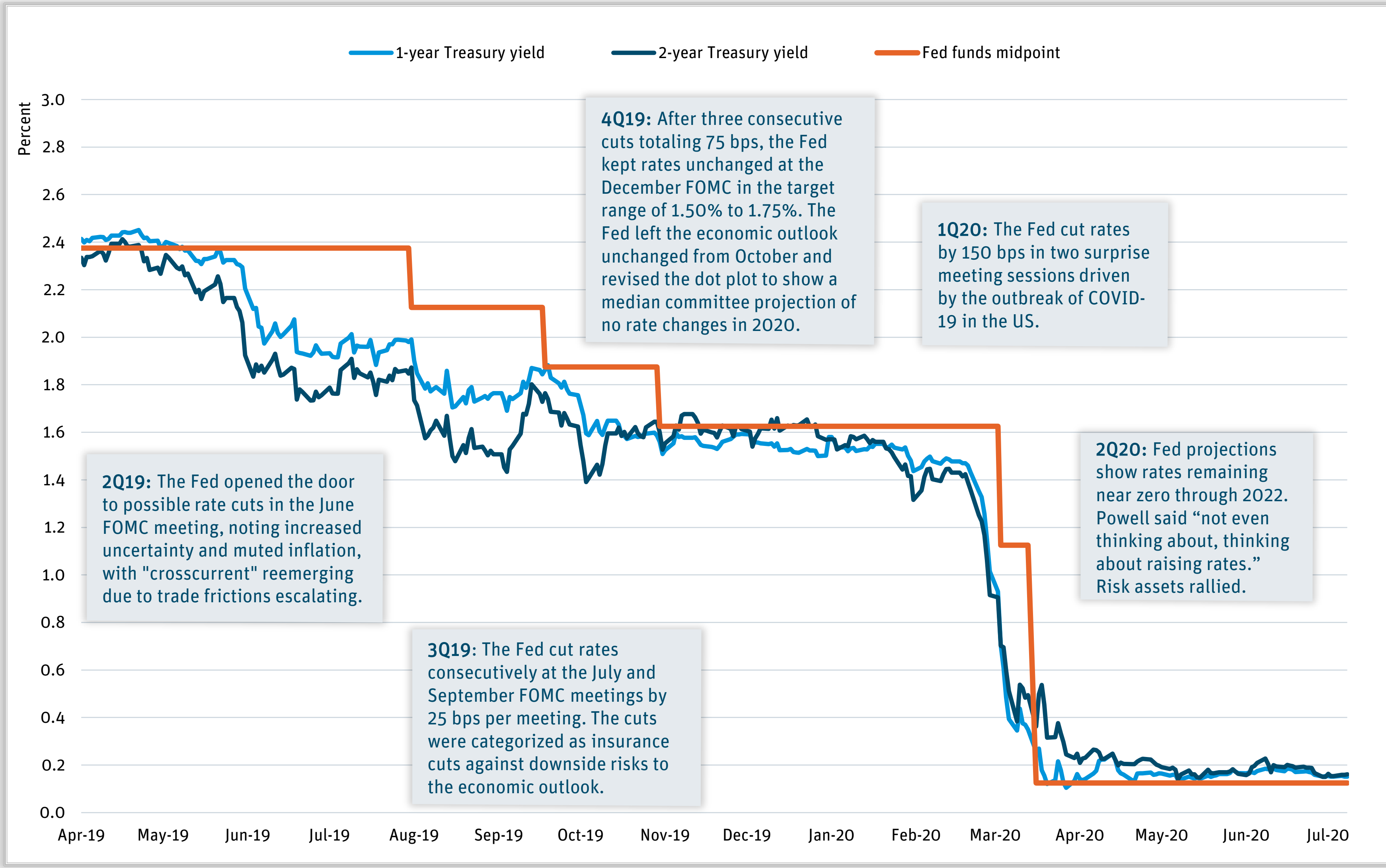
Central Banks

Historical Interest Rates

The Fed cut the fed funds rate to zero in March 2020 and remains committed to purchasing assets with an “unlimited” capacity.



Sources: Bloomberg and SVB Asset Management. Data as of 7/14/2020.

Federal Reserve Board Establishes Emergency Facilities

Facility	Summary	Size	Usage since March 15, 2020
Treasury and MBS Asset Purchases	Purchases Treasuries, agency MBS and agency CMBS	Unlimited	$2,444 billion
Commercial Paper Funding Facility (CPFF)	Purchases commercial paper directly from issuers	$10 billion Treasury protection	$4 billion
Primary Dealer Credit Facility (PDCF)	Allows dealers to-borrow cash by pledging collateral	TBD	$2 billion
Money Market Mutual Fund Liquidity Facility (MMLF)	Provides loans to dealers for purchasing securities from prime funds	TBD	$21 billion
Secondary Market Corporate Credit Facility (SMCCF)	Purchases corporate bonds and ETFs	$750 billion (combined total with PMCCF)	$10 billion
Primary Market Corporate Credit Facility (PMCCF)	Purchases corporate bonds and loans from eligible issuers	$750 billion (combined total with SMCCF)	None
Term Asset-Backed Securities Loan Facility (TALF)	Provides loans to companies collateralized with new-issue ABS, SBA loans, leveraged loans and CMBS	$100 billion	$0.3 billion
Foreign and International Monetary Authorities (FIMA) Repo Facility	Accepts Treasuries from eligible authorities	TBD	$1 billion
Small Business Administration's Paycheck Protection Program (PPP)	Provides loans collateralized by PPP loans by the SBA	$350 billion	$68 billion
Municipal Liquidity Facility (MLF)	Purchases munis from eligible states, counties and cities	$500 billion	$1.2 billion
Main Street Lending Programs: 1. Main Street New Loan Facility (MSNLF) 2. Main Street Expanded Loan Facility (MSELF) 3. Main Street Priority Loan Facility (MSPLF) 4. Nonprofit Organization New Loan Facility (NONLF) 5. Nonprofit Organization Expanded Loan Facility (NOELF)	Provide funding to banks in order to make loans to small- and medium-sized businesses, and nonprofit organizations	$600 billion Combined facilities	None

Sources: Federal Reserve and SVB Asset Management as of 7/17/2020.
Views expressed are as of the date of this content only and subject to change.

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	(6.5)%	5.0%	3.5%
Core PCE inflation	0.8%	1.6%	1.7%
Unemployment rate	9.3%	6.5%	5.5%
United Kingdom			
Change in real GDP	(14.0)%	15.0%	3.0%
CPI inflation	0.6%	0.5%	2.0%
Unemployment rate	8.0%	7.0%	4.0%
Eurozone			
Change in real GDP	(8.7)%	5.2%	3.3%
CPI inflation	0.8%	0.7%	0.9%
Unemployment rate	9.8%	10.1%	9.1%
Japan			
Change in real GDP	(4.0)%	3.35%	1.2%
Core CPI inflation	(0.5)%	0.4%	0.7%

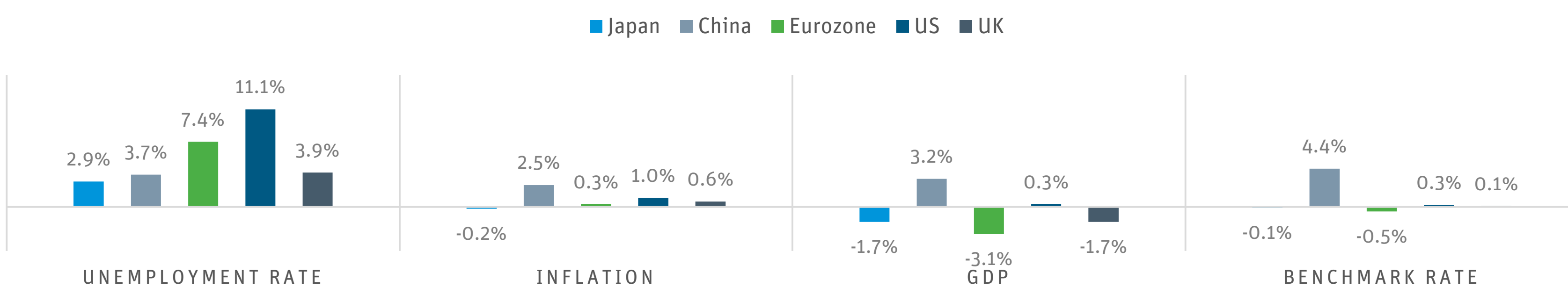
Sources: Federal Reserve, European Central Bank, Bank of Japan and Bank of England.
Per National People's Congress of China, this data is not applicable for China.
Data as of 7/14/2020. Forecasts are not available for all periods.

Central Banks: Activating afterburners

With the COVID-19 pandemic unabated and little room left for rate cuts, central banks are turning on quantitative easing measures and adopting other policies to loosen monetary conditions.

	Easing				
Current Monetary Policy	• Policy rate: -0.1% • 10-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: 3.85% • 1-year medium-term lending rate: 2.95% • Reserve requirement ratio (RRR): 12.5%	• Refinancing rate: 0% • Marginal lending facility: 0.25% • Deposit facility: -0.5% • QE: €1,350 billion program total through mid-2021	• Fed funds target range: 0% to 0.25% • Interest on excess reserves: 0.10% • QE: No limit	• Bank rate: 0.10% • QE: Buying £745 billion in gilts and corporate debt
Analysis	While making no changes at its July meeting, the BOJ emphasized it could expand lending programs, cut interest rates, or take other action in the future.	PBOC did not make any changes in June, after cutting some rates 20 bps in April and cutting RRRs 50 to 100 bps for certain banks earlier in the year.	Added €600 billion to its bond buying program and extended it through mid-2021. Will maintain holdings via reinvestments until at least the end of 2022.	Set minimum monthly purchase amounts of Treasuries at $80 billion and mortgage-backed securities at $40 billion, without an end date.	Increased its QE program by £100 billion to £745 billion. While the nominal amount of the purchase program increased, the pace of purchases will slow.

SNAPSHOT OF 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 7/15/2020.

Markets and Performance

Broad Market Performance: “Off the lows”

The unconventional Fed facilities, along with the other monetary and fiscal policy responses, have helped improve financial markets ranging from bonds to equities — all have come off their late-March lows.

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%	Crude Oil 91.75%
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%	Wilshire 21.94%
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%	S&P 500 20.54%
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%	Gold 12.77%
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%	REIT 11.39%
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%	US Treasuries 8.71%
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%	US Aggregate 6.14%
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%	US IG Corp 5.02%
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%	US High Yield -3.8%

All returns above are on a total return basis. YTD 2020 returns are on an aggregate basis up to 6/30/2020. 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.

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Fixed Income Returns

High-grade corporate returns outpaced other asset classes as credit spreads significantly tightened in Q2 from their widest levels in late March. The rally in spreads can be attributed to the unprecedented support from the Fed with the unconventional liquidity facilities, and the US government's fiscal stimulus packages.

		Current Duration	Current Yield %	Annual Total Return %		Non-annualized Periodic Total Return %					
				*2020**	2019	Q2 20	Q1 20	Q4 19	Q3 19	Q2 19	Q1 19
US Aggregate Index	US Treasuries	7.15	0.50	*8.71*	6.86	0.48	8.20	-0.79	2.40	3.01	2.11
	US Agencies	3.73	0.72	*5.06*	5.89	0.88	4.14	-0.09	1.74	2.32	1.81
	Corporates	8.54	2.19	*5.02*	14.54	8.98	-3.63	1.18	3.05	4.48	5.14
	US MBS	2.07	1.36	*3.50*	6.35	0.67	2.82	0.71	1.37	1.96	2.17
	US ABS	2.11	0.85	*3.32*	4.53	3.54	-0.21	0.39	0.92	1.67	1.48
	US CMBS	5.33	1.72	*5.19*	8.29	3.95	1.19	-0.33	1.89	3.28	3.24
US Short Duration	1-3 Year US Treasuries	1.93	0.17	*3.01*	3.59	0.25	2.76	0.51	0.58	1.47	0.99
	1-3 Year US Agencies	1.52	0.39	*2.42*	3.58	0.46	1.95	0.55	0.66	1.32	1.01
	1-3 Year Corporates	1.92	1.00	*2.48*	5.30	4.07	-1.53	0.86	0.96	1.55	1.83
	<1 Year Corporates	0.56	0.83	*1.28*	3.09	1.39	-0.11	0.58	0.68	0.85	0.94
	AAA Credit Card ABS	2.47	0.63	*3.90*	4.63	3.46	0.43	0.27	1.02	1.78	1.49
	AAA Auto ABS	1.80	0.75	*3.00*	4.21	3.18	-0.17	0.48	0.77	1.50	1.39

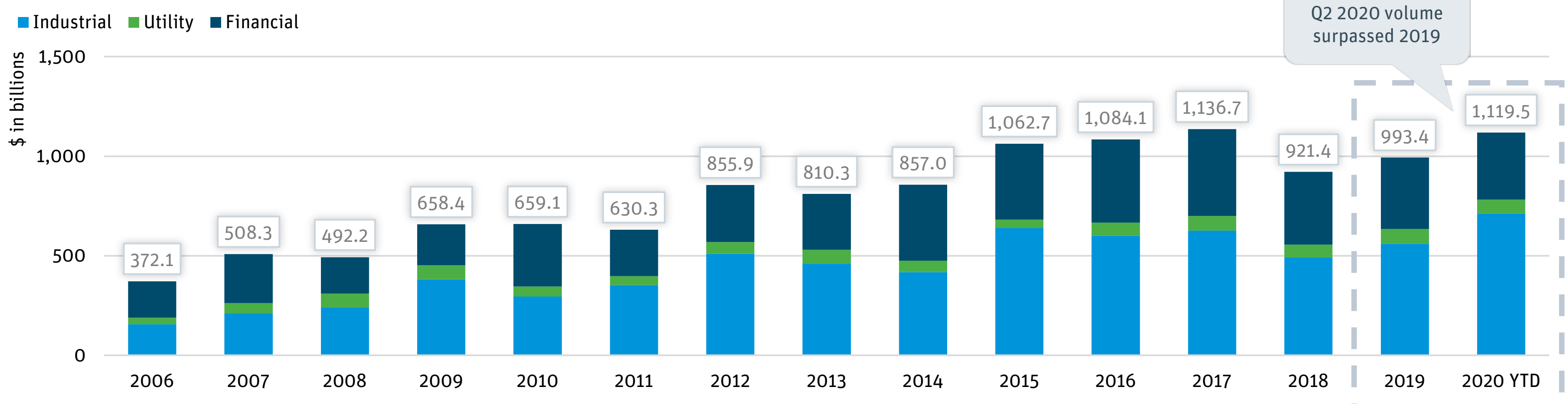
*Annualized periodic return data

Sources: Bloomberg Barclays indices. Data as of 6/30/2020. Heatmap colors based on periodic return percentage for time period shown. Past performance is not a guarantee of future results.

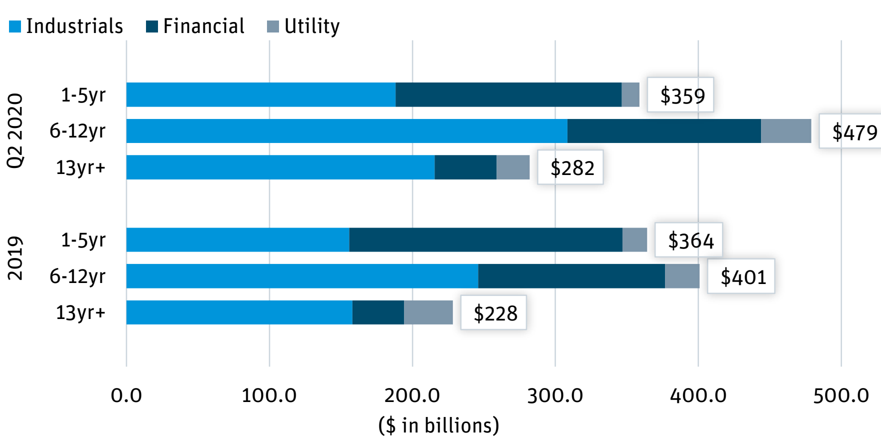
New Issues Keep Coming

New issuance through Q2 for US investment grade (IG) corporates has surpassed 2019 volume with six months to go. The non-financial new-issue volumes doubled financial issuers as of the end of Q2. Nearly 70 percent have been over six years, while 80 percent of the volume came from A-rated to BBB-rated borrowers.

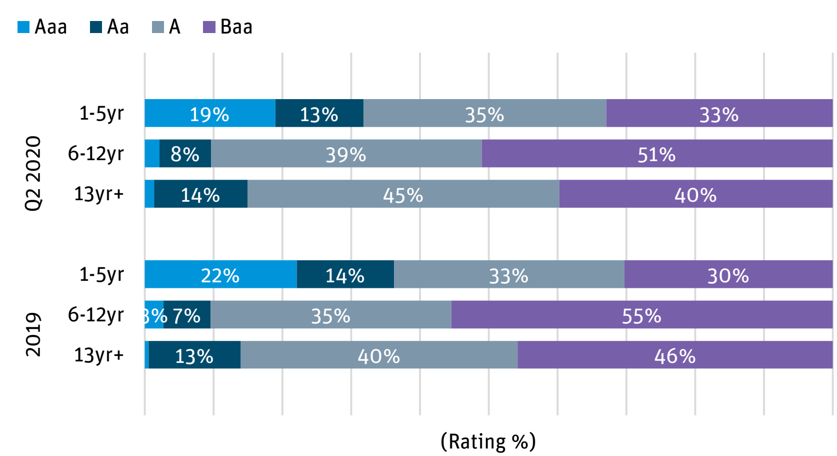
US Investment Grade Corporate New-Issue Volume



IG Corporate New Issue Supply (Sector/Maturity)



IG Corporate New-Issue Supply (Rating %/Maturity)

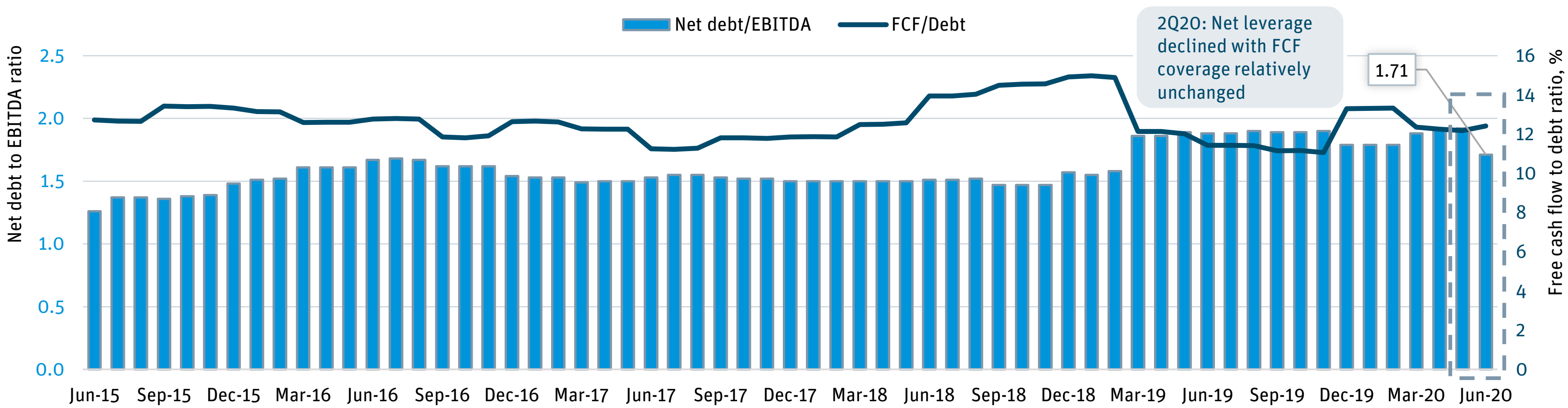


Sources: Bloomberg Barclays indices. Data as of 6/30/2020.
Past performance is not a guarantee of future results.

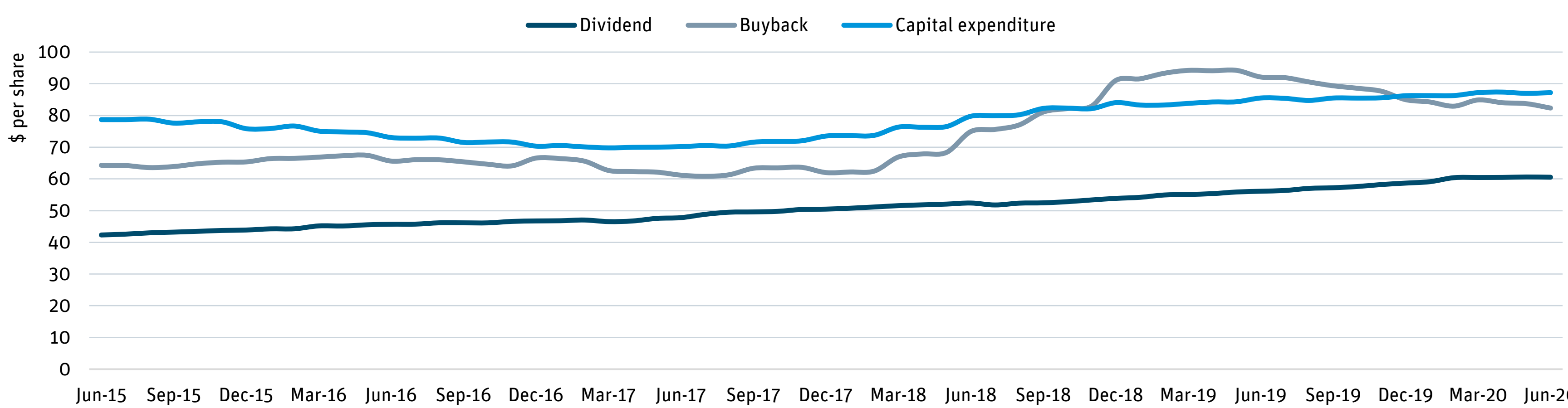
Corporates: Debt growth and corporate spending

Net leverage declined since last quarter due to increasing cash balances while free cash flow coverage was relatively unchanged. Corporate spending on capital expenditure and share buyback has tapered off.

S&P 500 Leverage and Debt Coverage



S&P 500 Capital Spending and Distribution

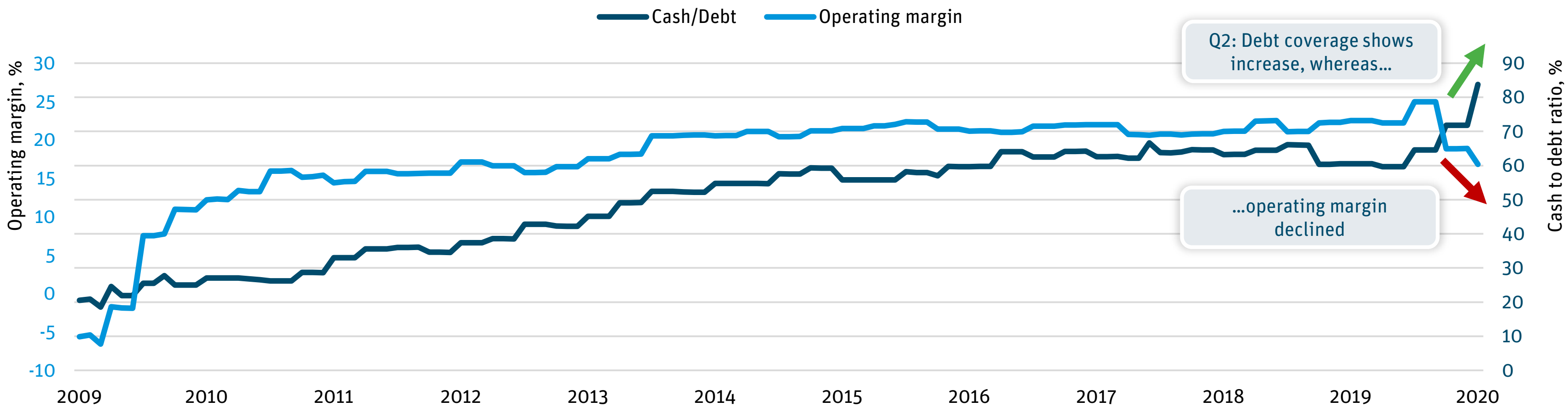


Source: Bloomberg. Data as of 6/30/2020.

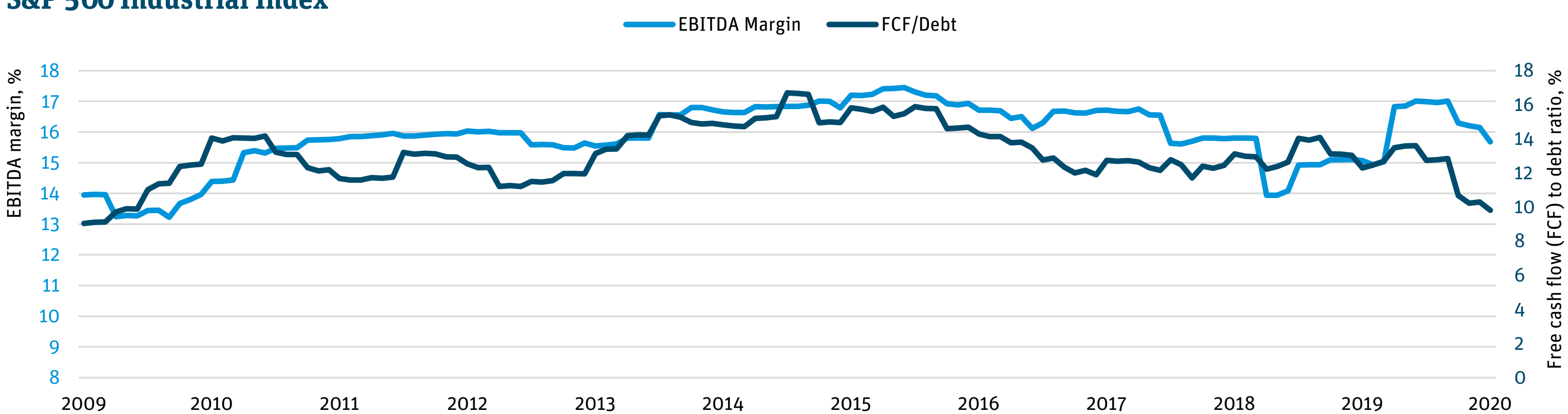
Corporates: Operating margin and debt coverage

Operating margin declined in two major sectors due to COVID-19 impacts. However, debt coverage showed a notable contrast as the financial sector benefited from increased liquidity.

S&P 500 Financial Index



S&P 500 Industrial Index

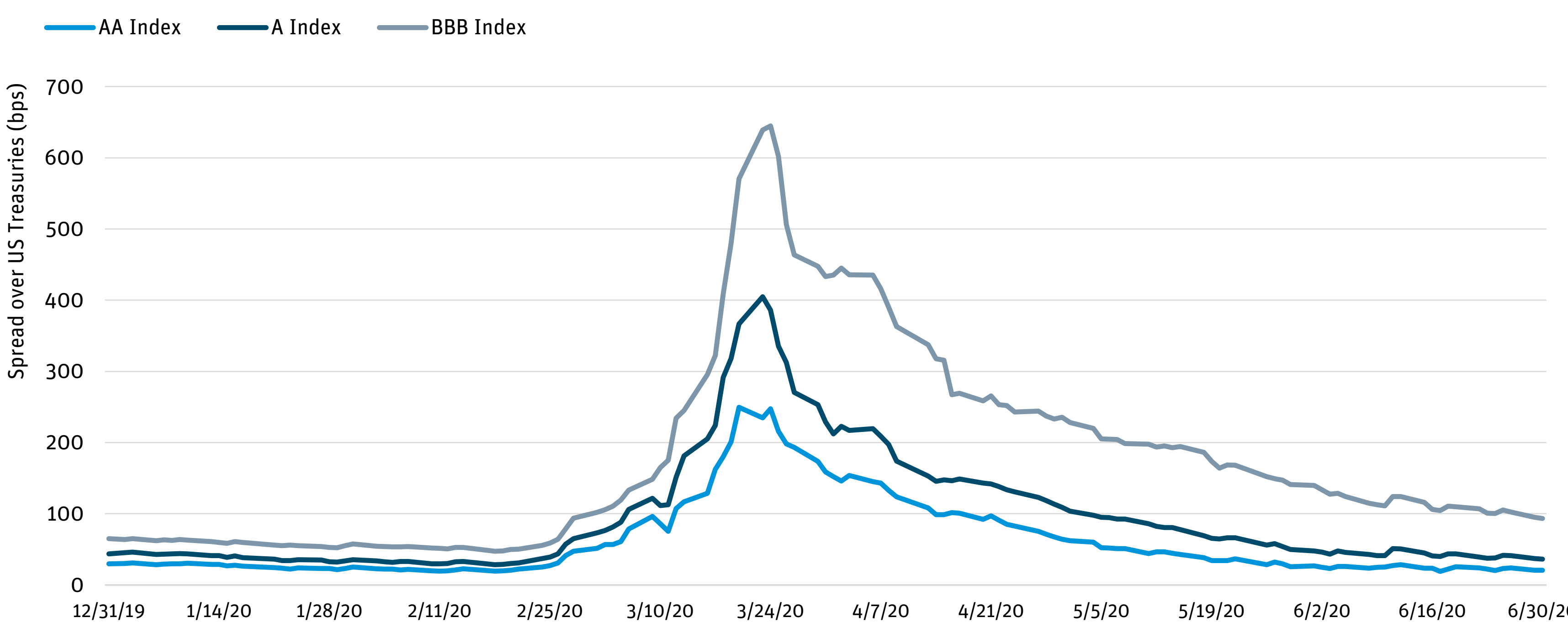


Source: Bloomberg. Data as of 6/30/2020.

Credit Spreads Update

Front-end spreads have narrowed significantly since late March with the double-A and single-A indexes returning to levels seen at the beginning of the year. Credit continues to offer attractive yields relative to comparable Treasury maturities.

Bloomberg Barclays Short-Term Indexes (1-year maximum maturity) Spread Changes



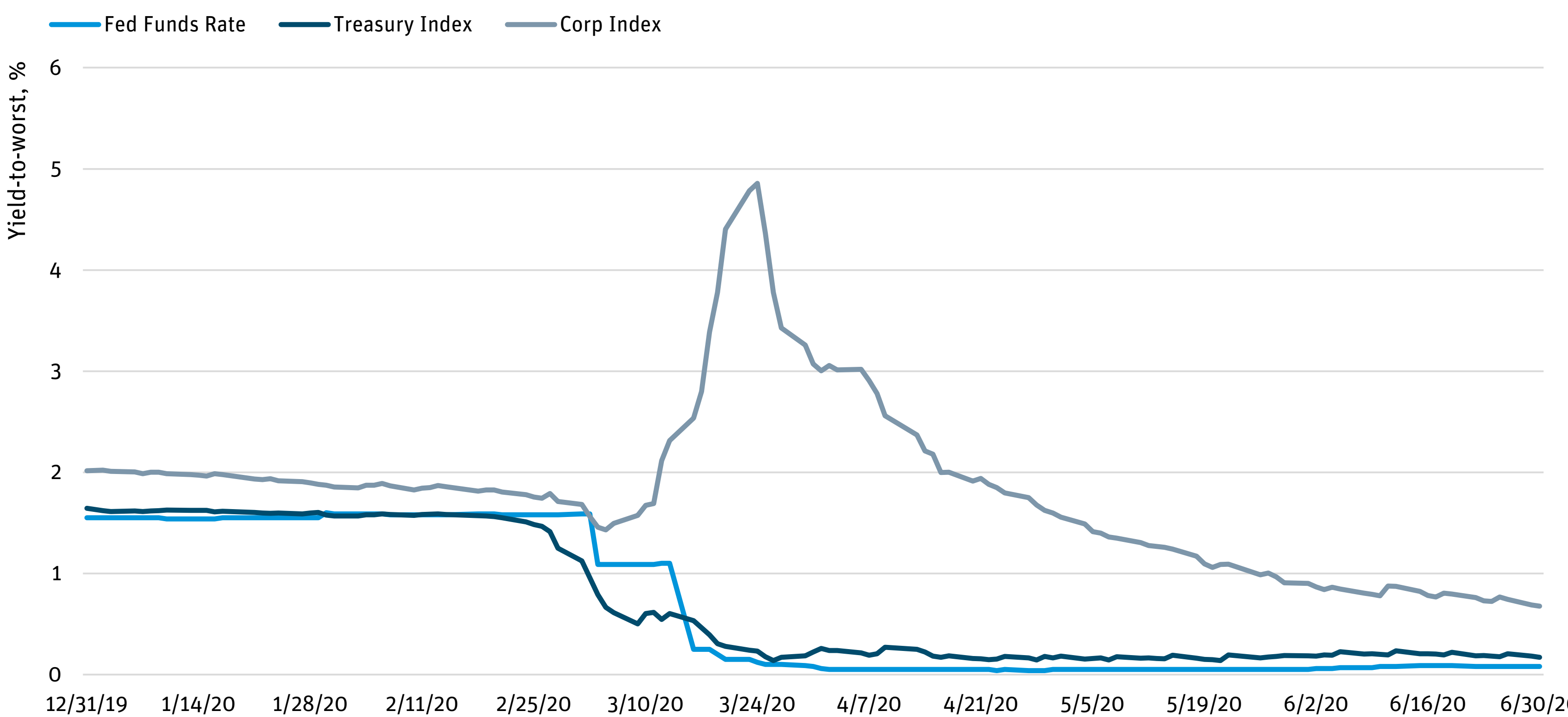
	12/31/19	1/31/20	2/28/20	3/23/20	4/30/20	5/29/20	6/30/20
AA Index	29	25	47	235	64	25	21
A Index	43	35	65	405	109	50	36
BBB Index	65	57	94	639	235	141	93

Sources: Bloomberg, Barclays Capital and SVB Asset Management. Data as of 6/30/2020.
Views expressed are as of the date of this content only and subject to change.

Relative Value: Government yields projected to remain low

Short-Term Treasury and government money market fund yields track very closely to the federal funds rate. The Fed is projecting no rate changes through 2022. Credit offers attractive yields relative to comparable Treasury maturities and money market funds in a low-interest-rate environment.

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



Source: SVB Asset Management and Bloomberg. Data as of 6/30/2020. Past performance is not a guarantee of future results. The above is not to be construed as a recommendation for your particular portfolio.

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