AMBIT

Acumen at work

Global Private Client

The Liquidity Gush

May 10, 2020

Executive Summary – The Liquidity Gush

Global Private Client

- As economies across the globe have come to a grinding halt due to shut downs, central banks & governments have announced a slew of liquidity measures leading to a potential liquidity gush
- The stimulus has been unprecedented both in terms of quantum & rate at which injected into the economies
- In this note we explore the potential impact of the liquidity released into the Global economy
    - **Short Term** **-** Immediate path the liquidity is most likely to take in the economy, markets & asset classes
    - **Medium Term** **-** Impact on the economic fundamentals like GDP Growth, Inflation & Earnings Growth
    - **Long Term** **-** Will this lead to devaluation of currencies & potential deflation or reflation across asset classes

Central Banks & Government response to Covid - 19

Global Private Client

Central banks & Govts. have announced a slew of liquidity measures in aggregate over USD 10 Trillion to counter the crisis

Central Bank	Amount up to (USD Trillion)	Policy Response (Announced)
Federal reserve	4.00	▪ Loans, Asset Purchases, Swaps
ECB	0.79	▪ Emergency fund for bond purchase programme
Bank of England	0.25	▪ 1st round of easing, more rounds are under consideration
People Bank of China	0.08	▪ To Virus impacted regions
Reserve bank of Australia	0.06	▪ Coronavirus support fund
Reserve Bank of India	**0.05**	▪ **Adapts whatever it takes policy, however liquidity stuck in banking system**
Total	**5.23**	

- Apart from the USD 5.23 Trillion of monetary stimulus, G20 nations would be spending over USD 5.0 Trillion in Fiscal stimulus taking total stimulus to over USD 10.3 Trillion

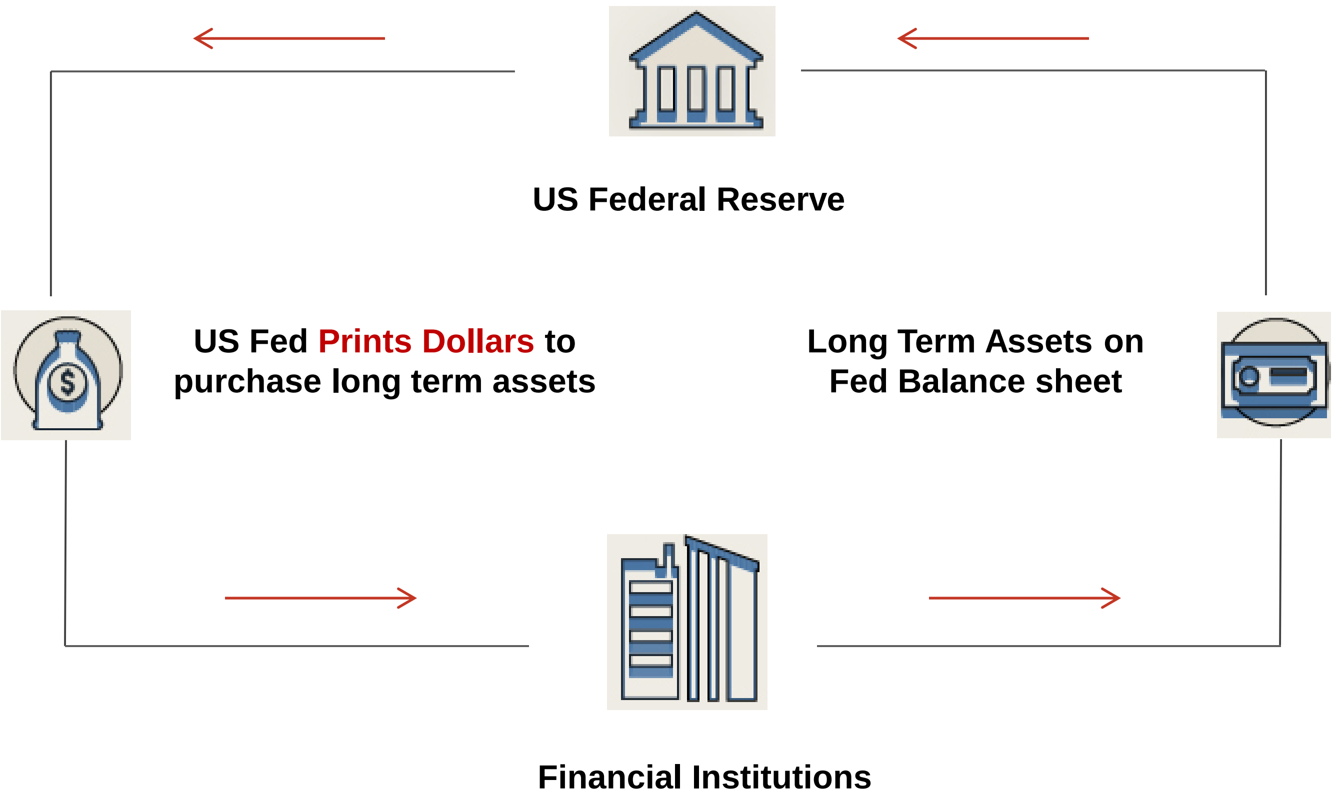
- In comparison India's stimulus measures seems to be underwhelming may be partly due to fiscal constraints

This is the highest stimulus ever in the history of world economies leading to gush of liquidity in the markets

Sources: Research Gate – The Fed Reserve system balance sheet - Ozli, Stanford - (SIEPR), Bloomberg, Stories of 4 quantitative easing – BW Fawley

How Does Fed’s QE works ?

Expansionary Monetary Policy where central banks purchase large amounts of long term assets & infuse liquidity into the economy



Fed Prints Dollars

↓

Flows to Banks, FIs

↓

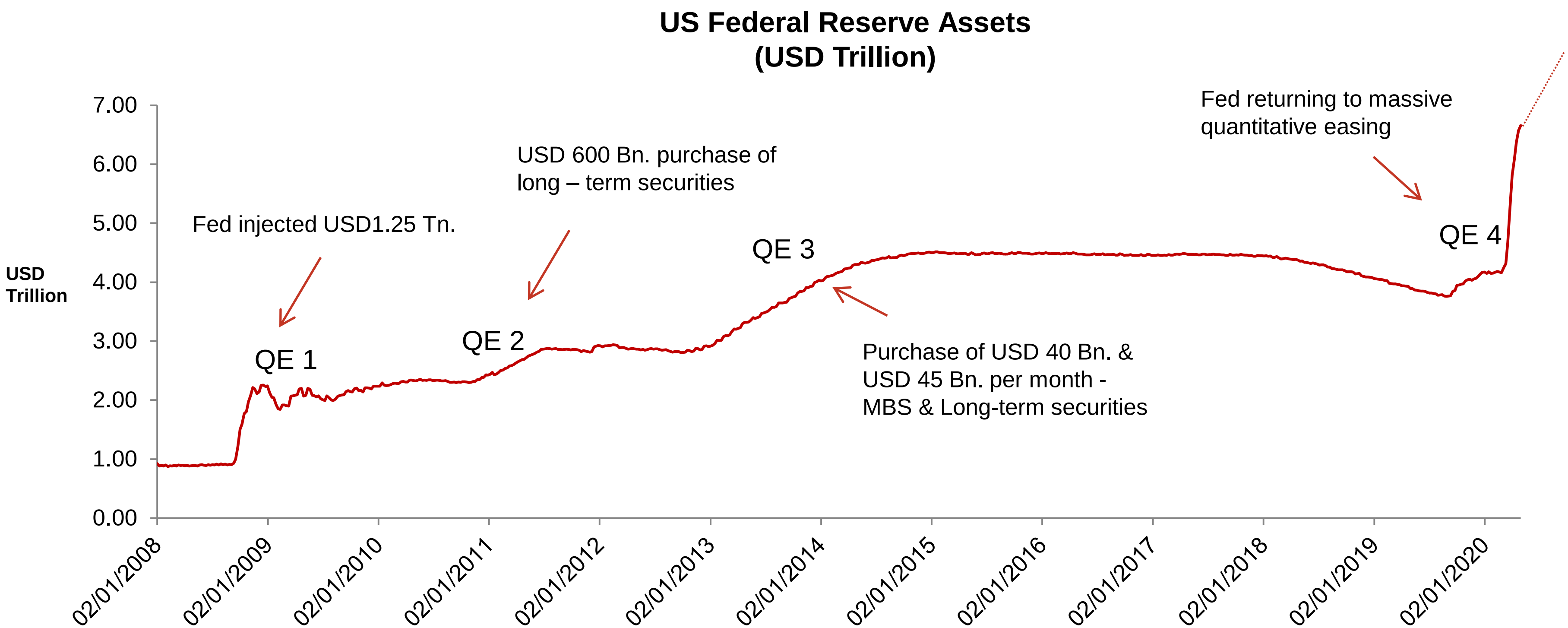
Flows to Corporates & Markets

Purchases intend to - Add money to the economy, Lower borrowing cost, Support economy & jobs

Sources: Fed Balance Sheet the other exponential curve – Visual Capitalist Marcus Lu, Bloomberg

Timelines of US Fed Action

- Fed relying on quantitative easing to soften economic blow of Covid - 19

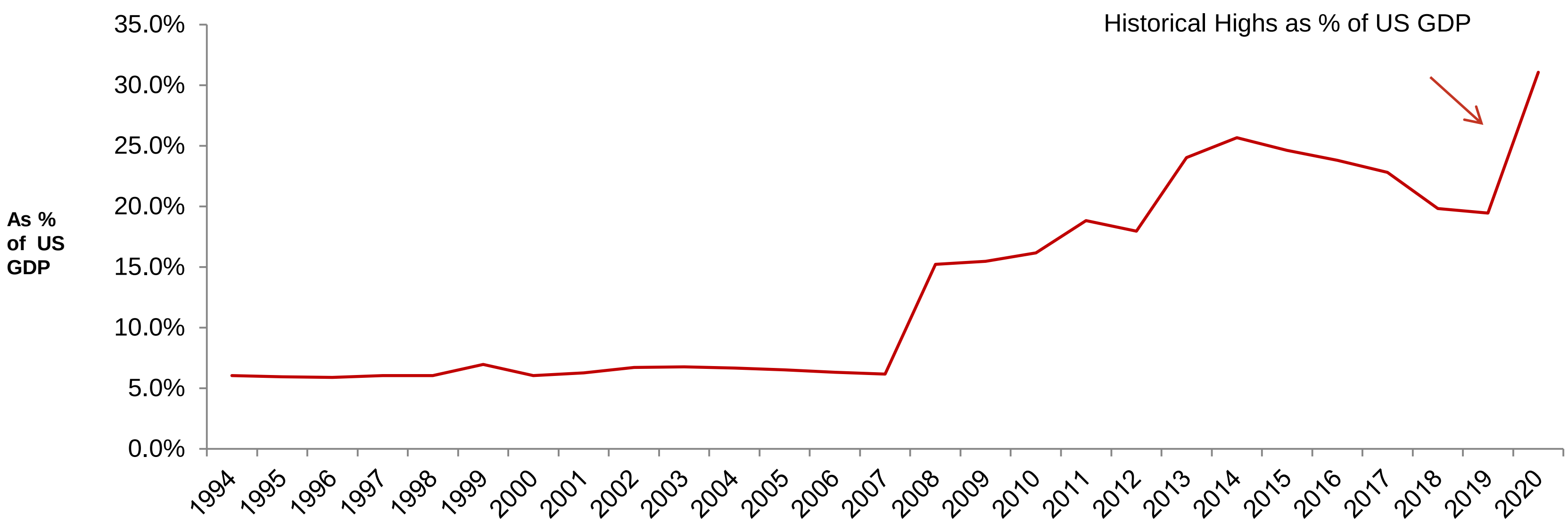


Expansion of US Federal Reserve Balance sheet can be termed as both the fastest & largest in US history

Sources: Bloomberg, Britannica. Forbes, MBS – Mortgage Backed Securities ········ Expected Fed Assets or Balance Sheet

AMBIT
Acumen at work
Global Private Client

US Federal Reserve Assets as % of US GDP



- Increasing influence of US Federal Reserve can be seen in both absolute & relative terms as **% of over all US GDP**
- Influence of Federal Reserve can also be seen in Fed's ability to revive credit cycle in the economy

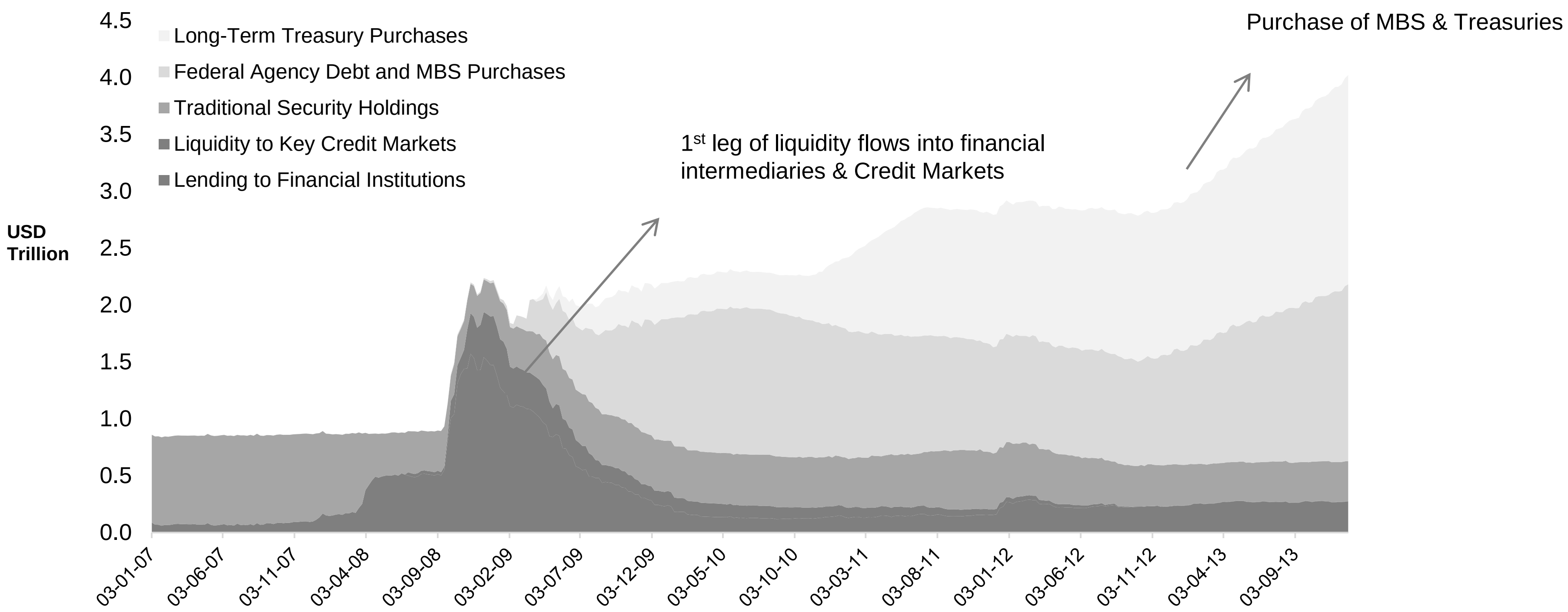
Fed balance sheet expansion is expected to have a counter cyclical impact on the economy

Sources: Bloomberg, Britannica. Forbes, GDP – Nominal, Fed Asset or Balance Sheet, Observations from previous cycles

Fed Liquidity Path : Global Financial Crisis

Global Private Client

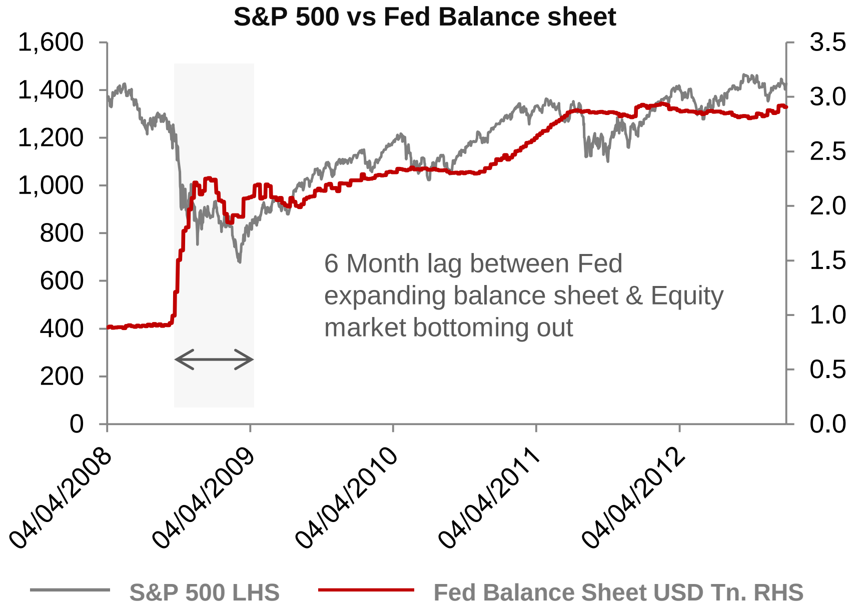
- When fed expands asset base, the 1st leg of liquidity flows into Financial Firms & Intermediaries
- Then into financial instruments & Securities - Bonds & Mortgage Backed Securities (MBS)

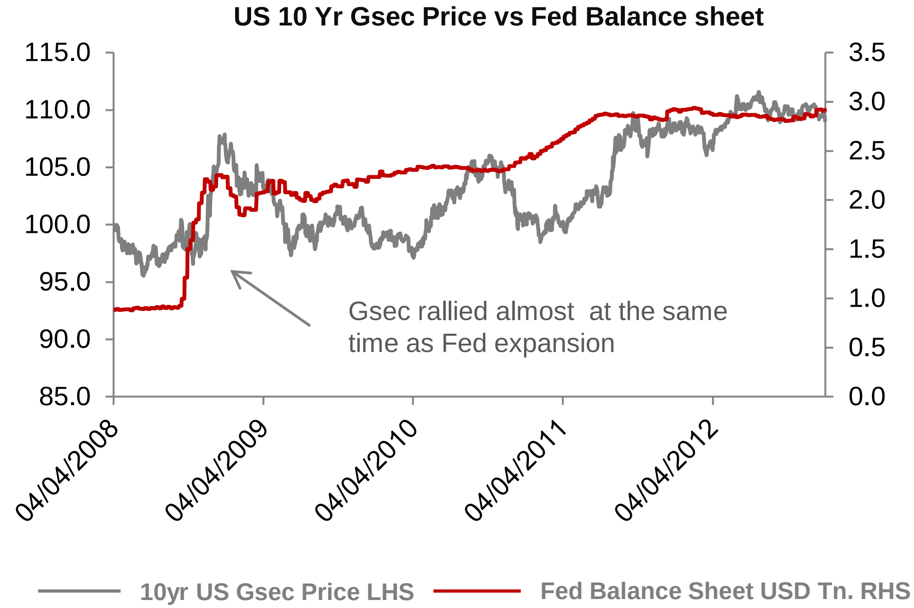


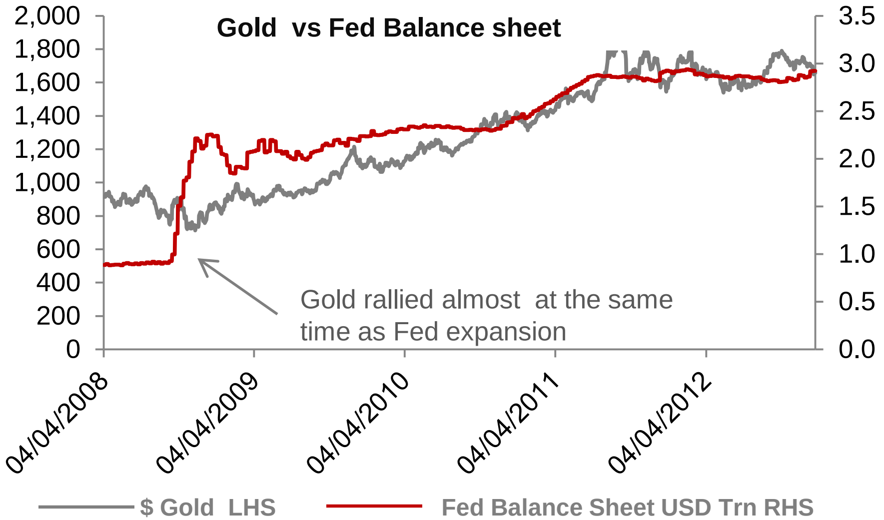
Sources: Bloomberg, Money & Banking – Fed goes to War, Forbes, Observation from previous cycle 2008 & indicative only

Fed Balance Sheet expansion impact on Equity, Debt & Gold

AMBIT
Acumen at work
Global Private Client







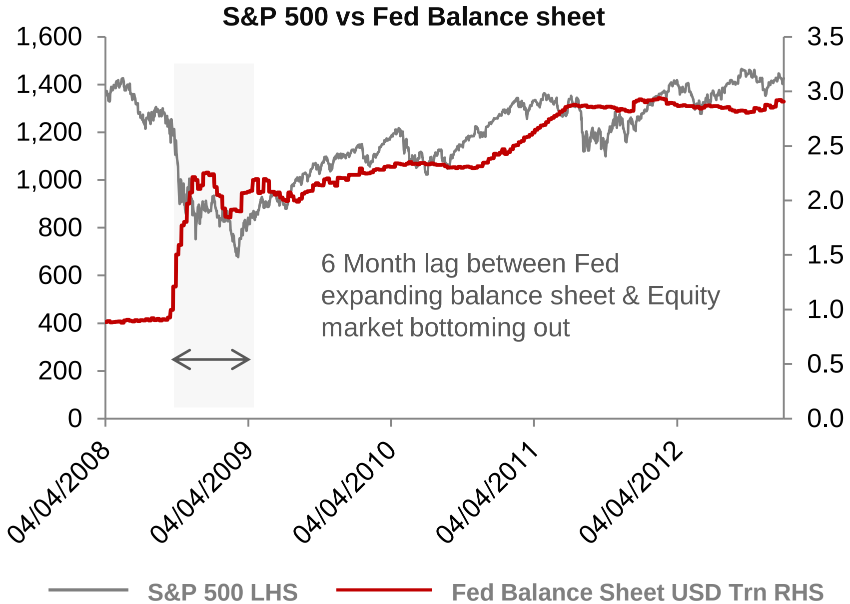
Key Observations from the liquidity measures taken in 2008

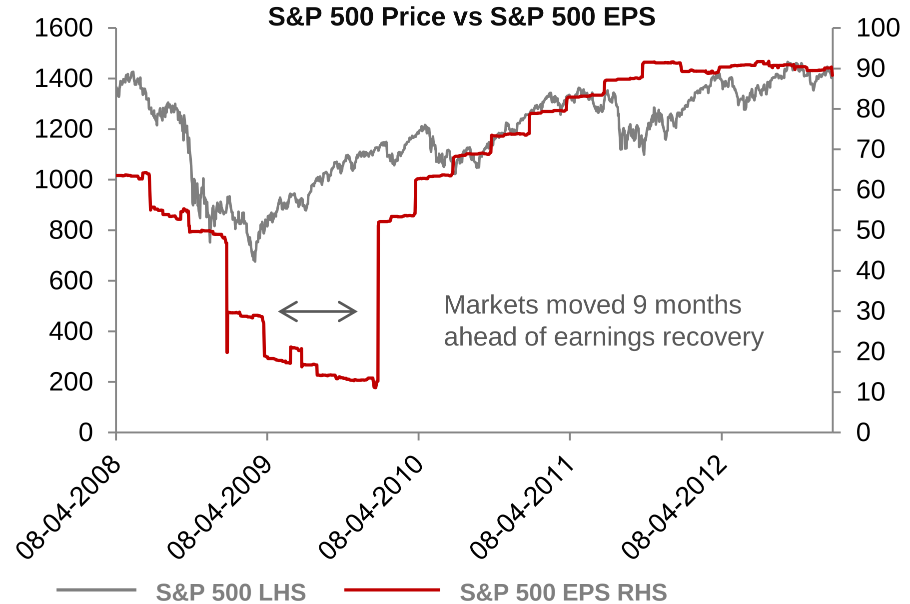
- **Gold & Gsec rallied immediately as Fed expanded (Risk Off)**
- **Equity rally lagged Fed expansion by 6 to 9 months (Risk On)**
- **All Asset classes reflate over time as Fed expands balance sheet**

Sources: Bloomberg, LHS – Left Hand Side, RHS – Right Hand Side, 10 yr Gsec – Generic clean price indicative only

Fed Balance and S&P 500 Price and Corporate Earnings

Global Private Client





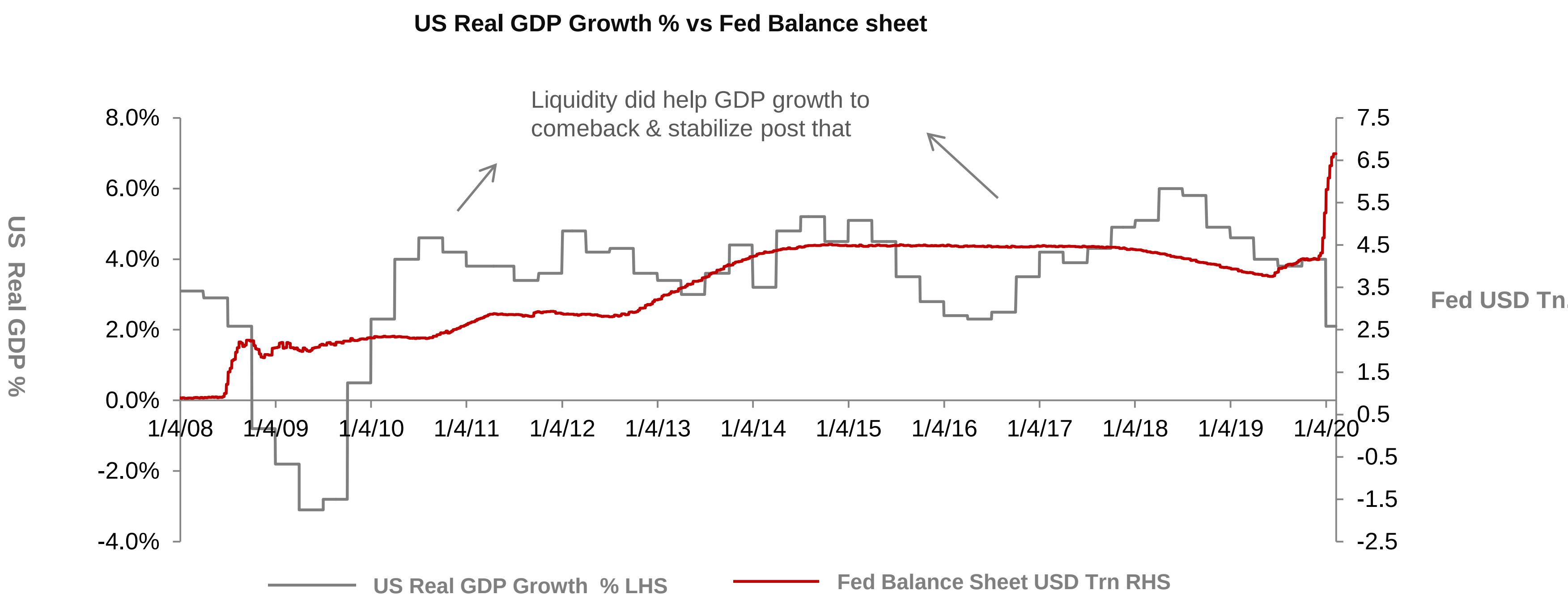
Fed Expanding balance sheets	T – Event of expansion
⬇	⬇
Risk Off Assets - Gold & Gsec rallying almost simultaneously	T + 0 to 1 Months
⬇	⬇
Risk On Assets - Equity start rallying after lag of 6 -9 months	T + 6 to 9 Months
⬇	⬇
Revival of Corporate Earning after 12 to 15 months	T + 12 to 15 Months

Sources: Bloomberg, As per previous cycle 2008, Observations indicative only, LHS – Left Hand Side, RHS – Right Hand Side, EPS – Earnings per share

Fed Balance Sheet expansion impact on US GDP Growth

AMBIT
Acumen at work

Global Private Client

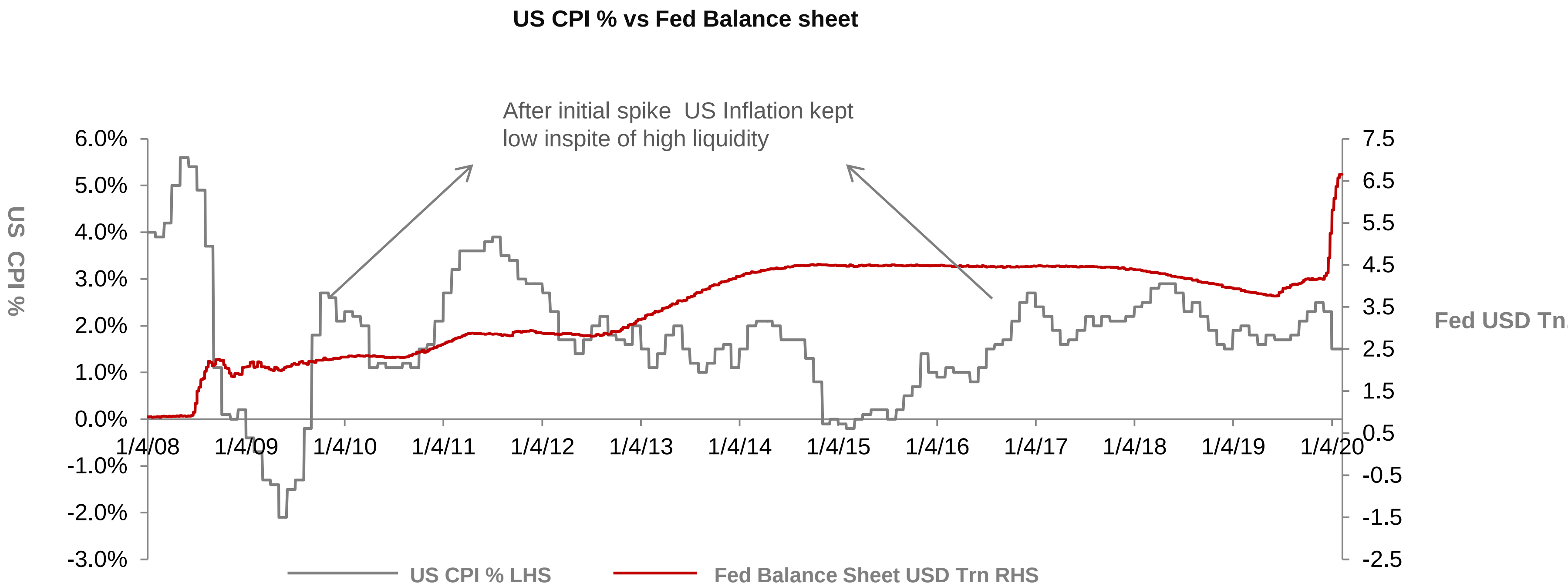


- Fed Reserve expansionary policies has helped US to come out of recession & stabilize GDP growth over a period of time
- However when Fed contracted the balance sheet in 2018 – 19 GDP growth slowed down as well

Sources: Bloomberg, LHS – Left Hand Side, RHS – Right Hand Side

Fed Balance Sheet and US CPI (Inflation)

AMBIT
Acumen at work
Global Private Client



- As Fed Reserve expanded balance sheet there was an initial spike in inflation, however inflation remained subdued post that inspite of easy liquidity conditions & leverage

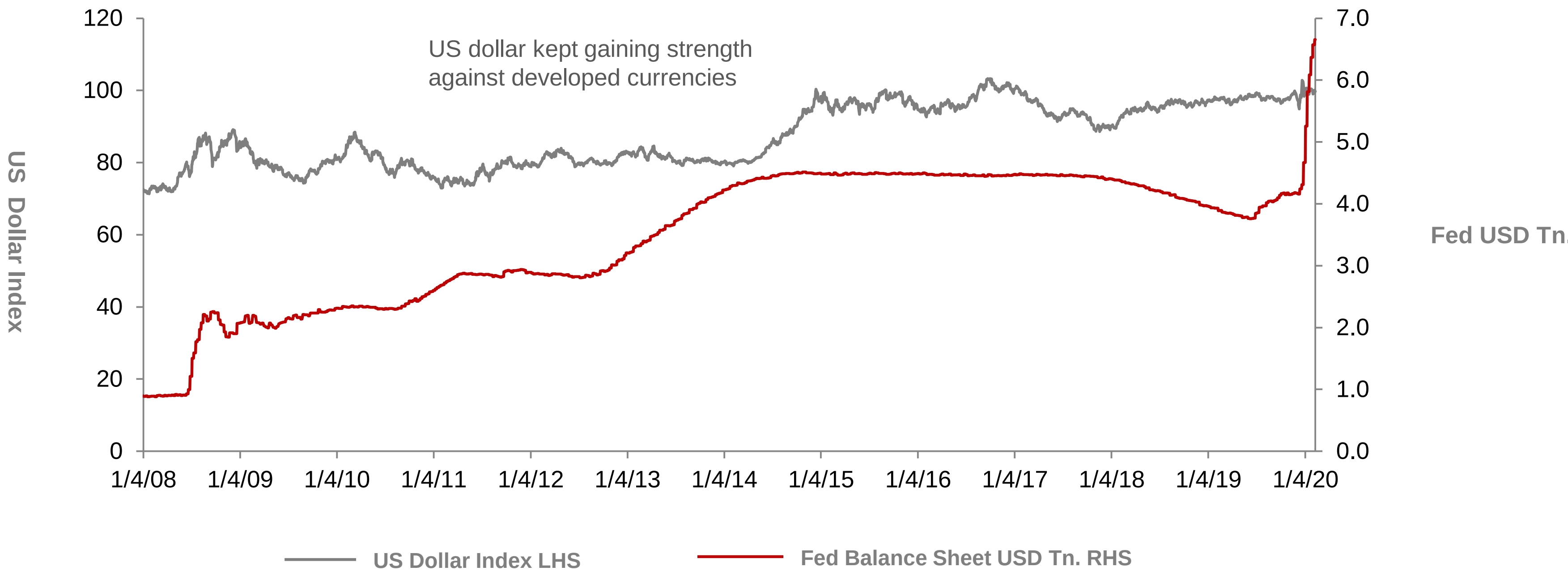
- Inflation remained subdued may be because of lower aggregate demand & supply side impacts of Technology & e-commerce players

Sources: Bloomberg

Fed Balance Sheet and the US Dollar Index

Global Private Client

US Dollar Index vs Fed Balance sheet



- US Dollar Index often referred to as a basket of U.S. trade partner’s currencies. The Index goes up when the U.S. dollar gains "strength" (value) when compared to other currencies – Euro, Japanese Yen, Pound Sterling, Canadian dollar etc.

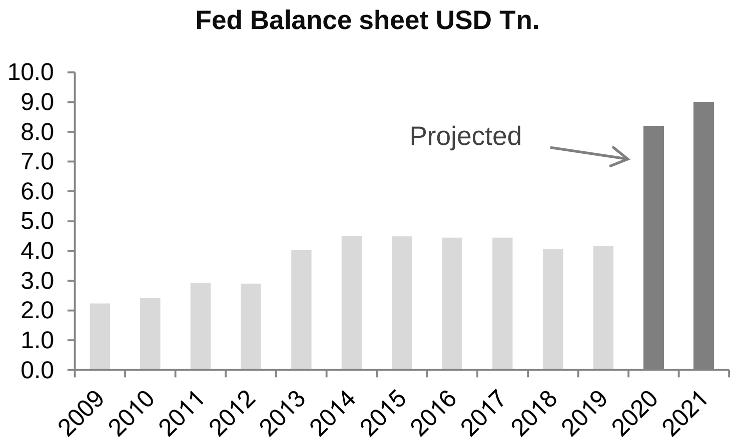
Perhaps the most interesting observations is that US dollar kept getting stronger against all major currencies inspite of Feds easy liquidity & expansionary policies

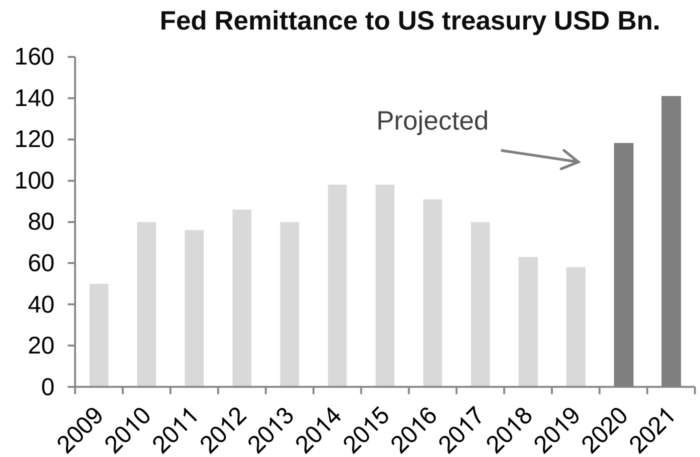
Sources: Bloomberg, Wikipedia, LHS – Left Hand Side, RHS – Right Hand Side

What makes the Fed one of the worlds best Hedge Funds

AMBIT Acumen at work
Global Private Client

- Assistance from Federal Reserve doesn't come for free, every program from balance sheet expansion earns a spread
- Fed lends money by buying bonds, collateralized lending, swaps each earning spread of 0.5% to 8.0% p.a. generally





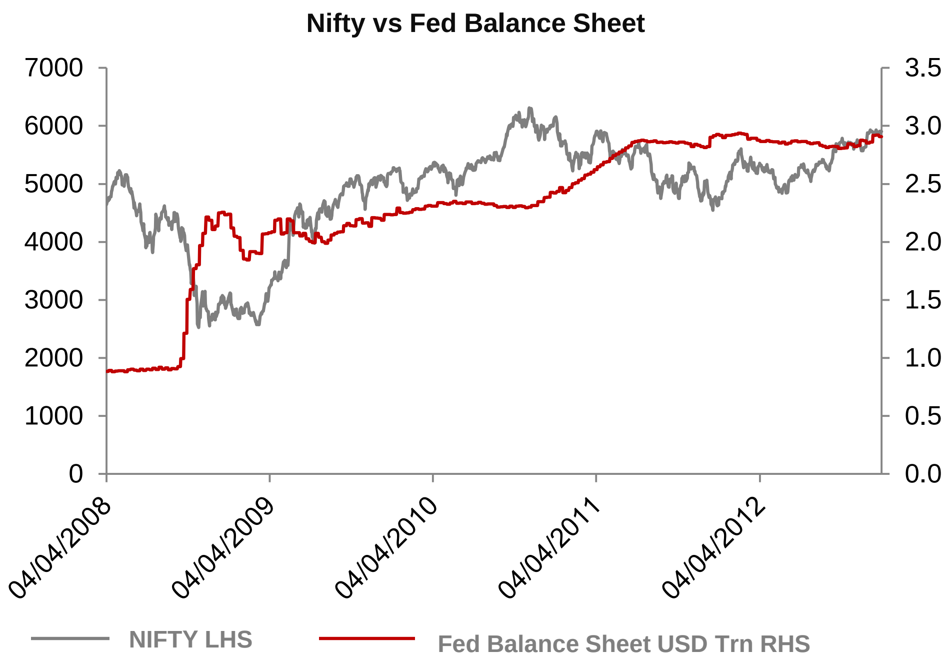
- The more the Fed expanded its balance sheet the more profits it made since 2008 (example : US Fed made up to $ 12.3 Bn. profit in Citibank investment alone)
- USD being the world reserve currency helps the Fed to expand balance sheet, invest & hold for longer time periods

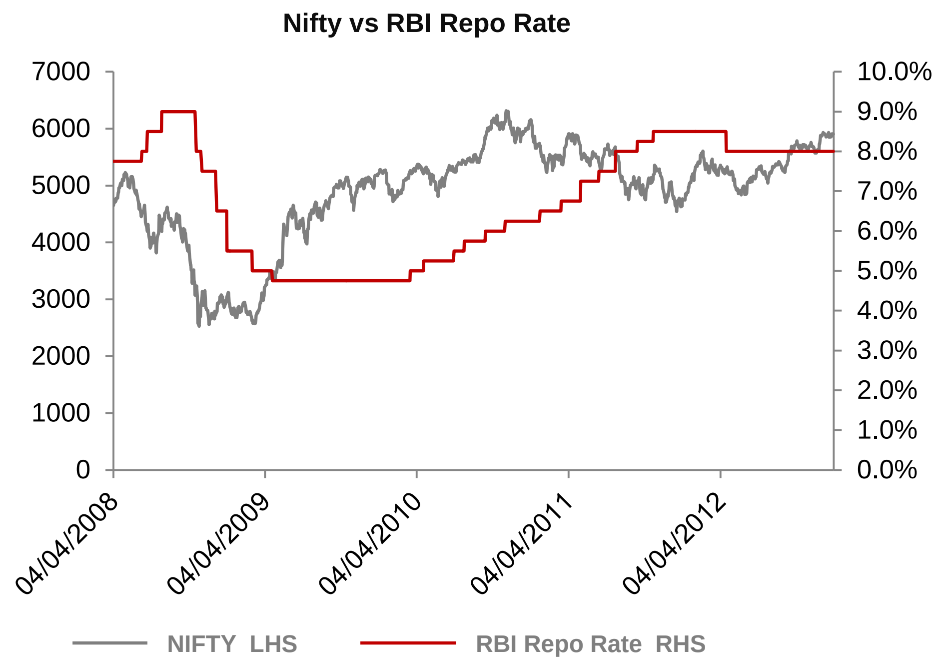
Fed Reserve tenets of expansion - Counter cyclical bailouts (investments) in risk assets and hold it for long term

Sources: Forbes, Bloomberg, The guardian

Fed Balance Sheet, RBI Rates vs Nifty

AMBIT
Acumen at work
Global Private Client





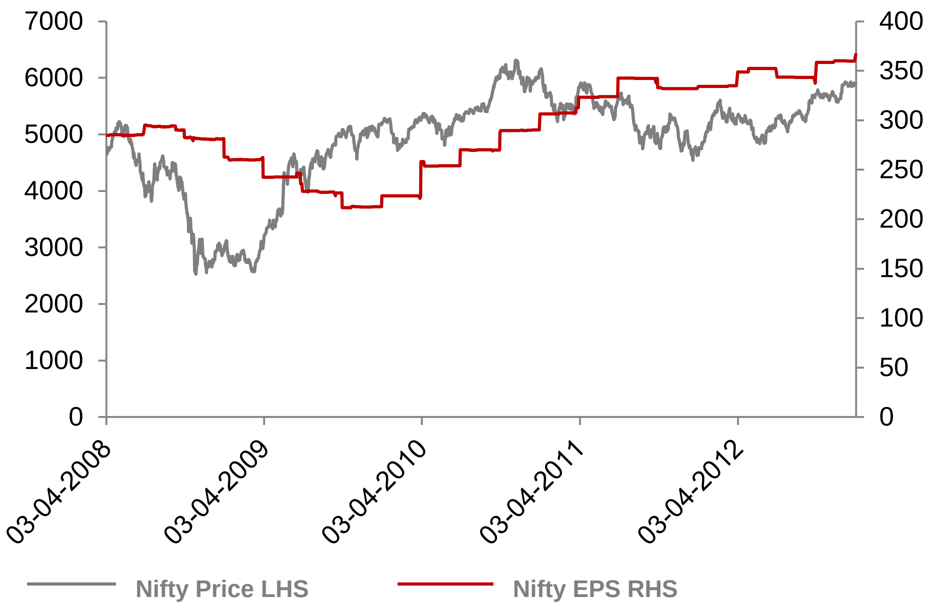
- Indian equity markets did well post Fed balance sheet expansion but with lag of 6 - 9 months
- RBI cutting rates aggressively also helped equity markets do well, markets bottomed out before rate cycle bottoming out

Sources: Bloomberg, Forbes, LHS – Left Hand Side, RHS – Right Hand Side

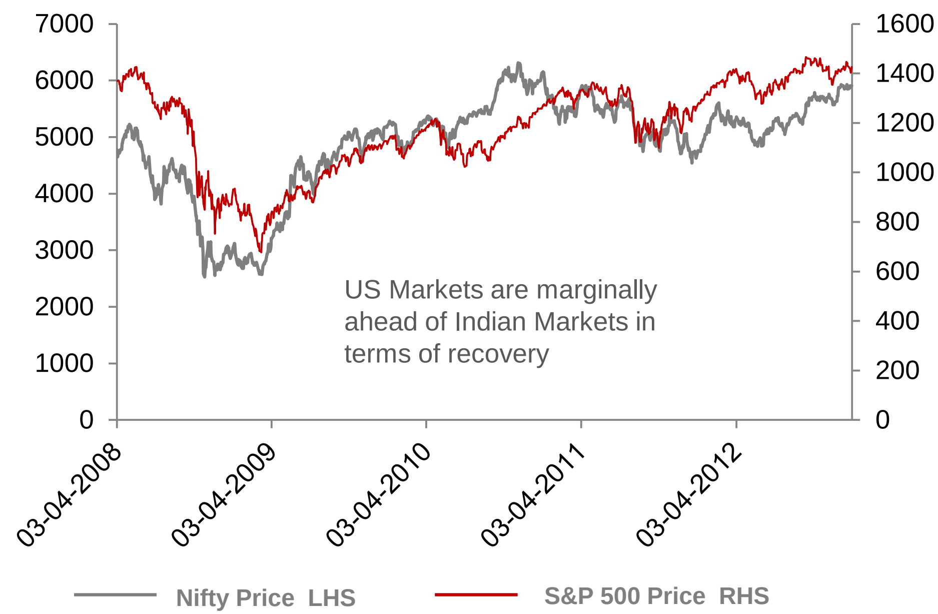
Corporate Earnings, S&P 500 vs Nifty

AMBIT
Acumen at work
Global Private Client

Nifty Price vs Nifty EPS



Nifty vs S&P 500



- Indian equity markets bottomed out 6 – 9 months before revival of corporate earnings
- US Equity markets led Indian Equity markets marginally in terms of recovery

Sources: Bloomberg, Forbes, Observations from 2008 cycle and indicative only, EPS – Earnings per share

Balance Sheet : Central Banks & Govt. Summary

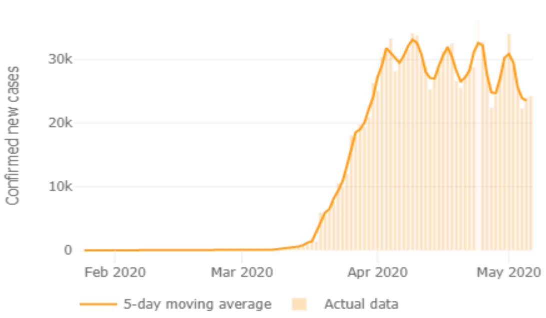
- Fiscal & Monetary stimulus up to USD 12.3 Tn. by central banks & govt. globally leading to unprecedented liquidity & balance sheet expansion
- Every cycle is unique & liquidity takes it own path into markets & economy, however observations from previous cycle are as below
  - Liquidity moves into Risk Off assets like Treasuries, Gold initially
  - Moves into risk assets like Equities with lag of 6 to 9 Months from date of balance sheet expansion
  - Revival in Corporate earnings took 12 to 15 months from date of balance sheet expansion
- US Dollar being reserve currency, Fed has the ability to print dollars and make counter cyclical balance sheet expansion (QE's) without worrying much about depreciation or inflation in the short term
- RBI & Govt. of India actions on Monetary & Fiscally policy stimulus has been underwhelming so far when compared to larger economies globally, however India is constrained by limited fiscal leeway

Sources: Forbes, Bloomberg, Britannica, Observations from previous cycles and indicative only

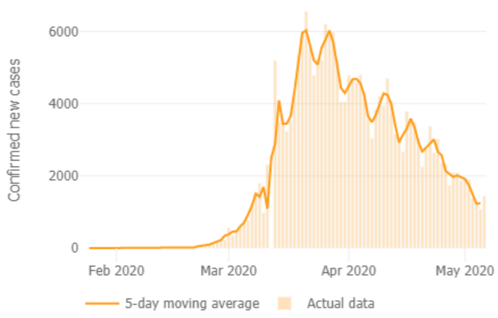
- As the unprecedented liquidity gush is in response to the Black Swan event the global spread of the Coronavirus pandemic and the equally unprecedented shut down of economies across the Globe (refer our report Black Swan & Markets Report April 04, 2020) its important to keep an eye on the spread of the virus

- While some countries where the virus impact was front ended are showing signs of plateau due to shut downs & social distancing - UK, USA, Spain, Netherlands, Italy, France & Belgium

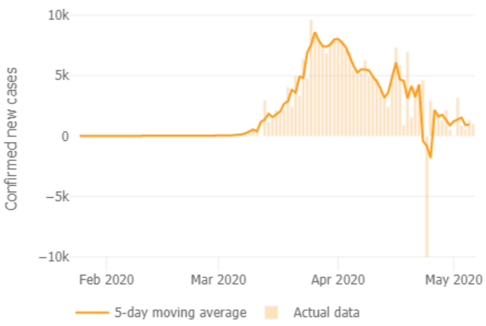
USA – Incidence of new Infections



Italy – Incidence of new Infections

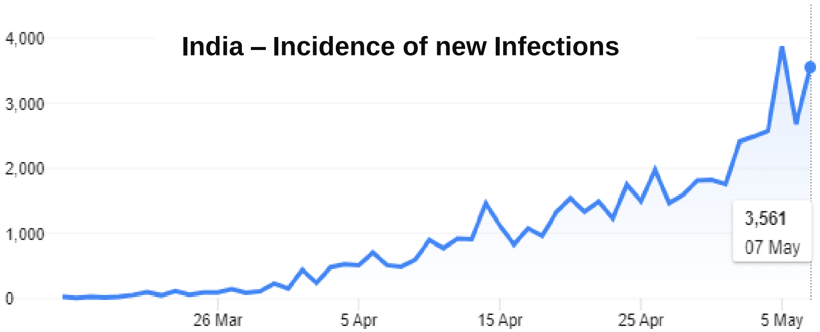


Spain – Incidence of new Infections



- Some countries like India where virus incidence has been later are still showing exponential growth

India – Incidence of new Infections



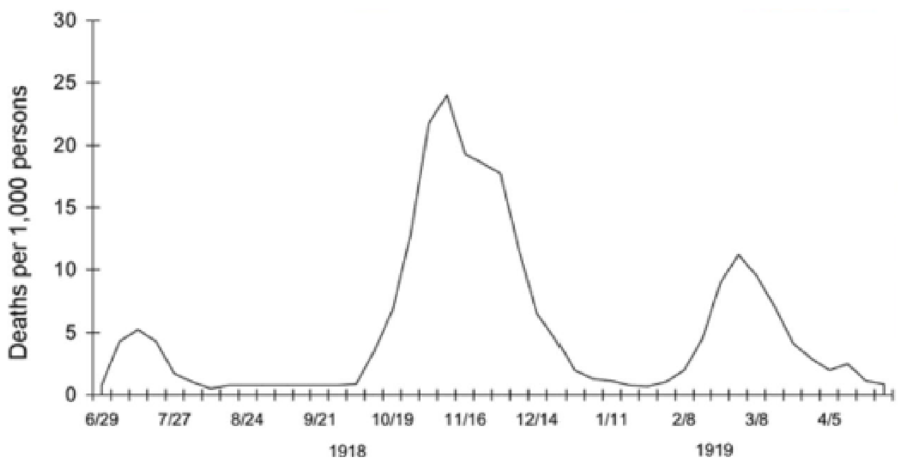
Sources: John Hopkins University

The key question is even in countries which have flattened the curve, will there be a 2nd wave once economies re open ?

- If we look back at the Spanish flu which was considered one of most severe pandemic in recent human history and lead to estimated deaths of 20 + million worldwide

- The Spanish Flu in total had three waves with
  - 1st wave starting in early 1918 appeared to be mild & ordinary symptoms & only 0.5% death rate
  - 2nd wave virus resurfaced in August 1918 & being most lethal of all the 3 waves with 2.5% death rate

Spanish Flu: No of deaths per 1000 across 3 waves



Sources: John Hopkins University

Coronavirus potential White Swan events

AMBIT
Acumen at work
Global Private Client

- While the jury is still out on the path which virus will take
- **Some of the potential White Swan events to track**
  - Earlier than expected vaccine or / and cure for the virus (12 - 18 months being expected timelines)
  - Lower or negligible incidence of new infections post re opening of economies
  - Ability to develop herd immunity to the virus
- White Swan event could be - Vaccine or Cure or Flatting of curve being achieved earlier than expected & especially given amount of global liquidity - markets & economies could stage a comeback

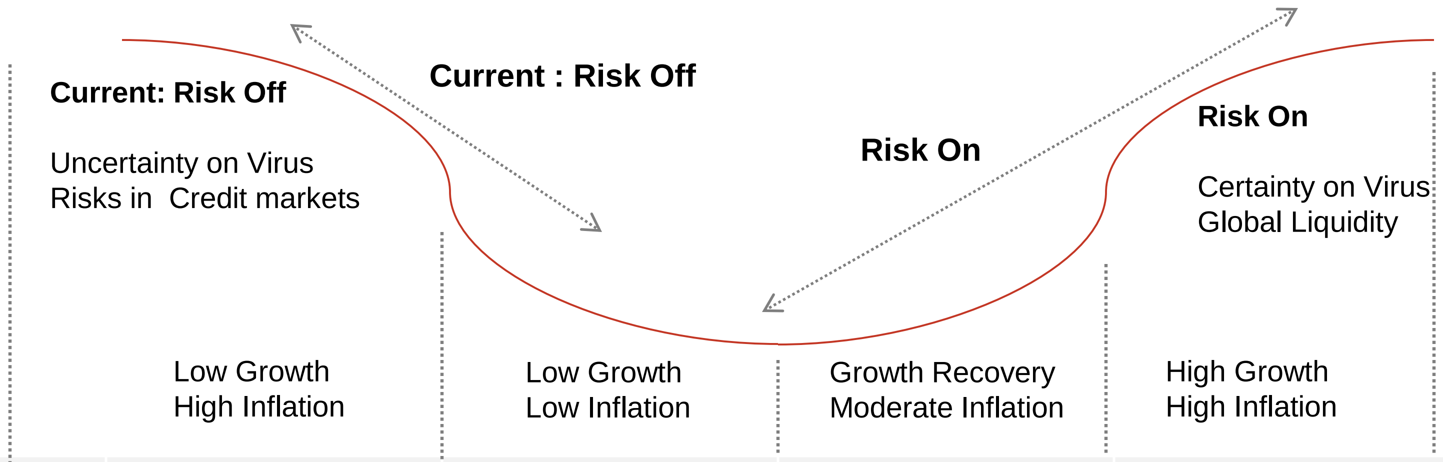
However till the time uncertainty prevails on the path of the virus & disruptions in the economy, we believe it is going to be Risk Off scenario in the short term inspite of global liquidity

Sources: John Hopkins University

Four Stages of Business Cycle

Global Private Client

- Theoretically there are four stages of business cycle – Slowdown, Contraction, Recovery & Expansion based on aggregate economic activity



	Slow Down	Contraction	Recovery	Expansion
Sectors	▪ Utilities ▪ Real Assets	▪ Consumer Staples ▪ Health Care ▪ Utilities & Tech	▪ Materials ▪ Telecom ▪ BFSI ▪ Technology	▪ Consumer Discretionary ▪ Industrials ▪ BFSI
Smart Factor	▪ Low Volatility ▪ Dividend Yield	▪ Low Volatility ▪ Quality, Large ▪ Cash Flow	▪ Growth ▪ Multi Cap	▪ Growth ▪ High Volatility ▪ Mid & Small

Sources: SSGA – Asset Performance & Business Cycle, Bloomberg, Britannica, Indicatively only

Asset Allocation

- We believe decisions on Asset Allocation are a function of where we are in business cycle & Growth – Inflation construct
- We are currently **Risk Off** across asset classes and will recommend focus on capital preservation till further clarity on Virus path & reopening of world economies

	Preferences
EQUITIES (U.W & Staggered)	▪ Large Caps ▪ Quality & Growth – Low Debt, Governance, Moats ▪ Utilities, Technology, Telecom, I.T, Pharmaceuticals, Consumer
FIXED INCOME (O.W & HTM)	▪ Government Securities (Gilts) – 1 to 3 yr tenor & dynamic based on liquidity ▪ Tax Frees, Banks, Select AAA papers ▪ Select Gold backed financials
GOLD (O.W)	▪ Sovereign Gold Bonds (SGB's) ▪ Gold Index Funds

U.W – Under Weight, O.W – Over Weight, E.W – Equal Weight, HTM – Hold To Maturity

Our Reports and views

AMBIT
Acumen at work
Global Private Client

Research reports from our Product & Investment Strategy Desk from the early days into the coronavirus crisis

- **Nifty Hedge Strategy: March 06, 2020 -** Purchase of put options at NIFTY levels of 11000 (upto 30% absolute returns)
- **Know the Now - The Pendulum Swings to Fear: March 08, 2020 -** recommended equity hedge and lighten equity allocation
- **Know the Now - What to Do Now.... in the Midst of the Fastest Bear Market Ever: March 16, 2020 -** Lighten equity allocation and hold fresh deployment in equities
- **Know the Now - Consequences of Easy Money, March 23, 2020 -** Rebalance portfolios towards high quality companies, AAA credits, staggered G-Sec and tax free bonds purchases, exited 50% of capital protection strategy
- **Long Duration Strategy: March 27, 2020 -** Long on interest rate futures
- **Know the Now - The New Indicators: March 30, 2020**
- **Black Swan and Markets: April 04, 2020**
- **Goldilocks for Gold: April 14, 2020**
- **Know the Now – Bull vs Bear: April 25, 2020 -** we argue both sides and recommend caution & Risk off

Author : Mahesh Kuppannagari, Head – Products & Advisory

Ambit Global Private Client Investment Team

Amrita Farmahan
MD & CEO
Amrita.farmahan@ambit.co

Mahesh Kuppannagari
Head – Products & Advisory
Mahesh.kuppannagari@ambit.co

Sunil Sharma
Chief Investment Strategist
Sunil.sharma@ambit.co

Malay Shah
Head – Fixed Income
Malay.shah@ambit.co

Thank You

Disclaimer

This presentation / newsletter / report is strictly for information and illustrative purposes only and should not be considered to be an offer, or solicitation of an offer, to buy or sell any securities or to enter into any Portfolio Management agreements. This presentation / newsletter / report is prepared by Ambit strictly for the specified audience and is not intended for distribution to public and is not to be disseminated or circulated to any other party outside of the intended purpose. This presentation / newsletter / report may contain confidential or proprietary information and no part of this presentation / newsletter / report may be reproduced in any form without its prior written consent to Ambit. If you receive a copy of this presentation / newsletter / report and you are not the intended recipient, you should destroy this immediately. Any dissemination, copying or circulation of this communication in any form is strictly prohibited. This material should not be circulated in countries where restrictions exist on soliciting business from potential clients residing in such countries. Recipients of this material should inform themselves about and observe any such restrictions. Recipients shall be solely liable for any liability incurred by them in this regard and will indemnify Ambit for any liability it may incur in this respect.

Neither Ambit nor any of their respective affiliates or representatives make any express or implied representation or warranty as to the adequacy or accuracy of the statistical data or factual statement concerning India or its economy or make any representation as to the accuracy, completeness, reasonableness or sufficiency of any of the information contained in the presentation / newsletter / report herein, or in the case of projections, as to their attainability or the accuracy or completeness of the assumptions from which they are derived, and it is expected each prospective investor will pursue its own independent due diligence. In preparing this presentation / newsletter / report, Ambit has relied upon and assumed, without independent verification, the accuracy and completeness of information available from public sources. Accordingly, neither Ambit nor any of its affiliates, shareholders, directors, employees, agents or advisors shall be liable for any loss or damage (direct or indirect) suffered as a result of reliance upon any statements contained in, or any omission from this presentation / newsletter / report and any such liability is expressly disclaimed.

You are expected to take into consideration all the risk factors including financial conditions, Risk-Return profile, tax consequences, etc. You understand that the past performance or name of the portfolio or any similar product do not in any manner indicate surety of performance of such product or portfolio in future. You further understand that all such products are subject to various Market Risks, Settlement Risks, Economical Risks, Political Risks, Business Risks, and Financial Risks etc. You are expected to thoroughly go through the terms of the arrangements / agreements and understand in detail the Risk-Return profile of any security or product of Ambit or any other service provider before making any investment. You should also take professional / legal /tax advice before making any decision of investing or disinvesting. Ambit or Ambit associates may have financial or other business interests that may adversely affect the objectivity of the views contained in this presentation / newsletter / report.

Ambit does not guarantee the future performance or any level of performance relating to any products of Ambit or any other third party service provider. Investment in any product including mutual fund or in the product of third party service provider does not provide any assurance or guarantee that the objectives of the product are specifically achieved. Ambit shall not be liable for any losses that you may suffer on account of any investment or disinvestment decision based on the communication or information or recommendation received from Ambit on any product. Further Ambit shall not be liable for any loss which may have arisen by wrong or misleading instructions given by you whether orally or in writing.