Equity Bear Markets Usually Boost the JPY, CHF

The volatility in the global financial system remains elevated. Central bank policy actions appear to have mitigated—to some extent—the continued increase in USD funding pressures we noted last week that might keep the USD better supported. However, the general undertone for risk assets remains weak and that usually means a better support for the JPY.

As stock market sell-offs go, this one has been remarkable—if only for the speed of the drop, which puts it in more or less the same class of the rapid rout in financial markets seen in late 1897. The sharp sell-off can be rationalized perhaps by the fact that markets had to quickly discount a short, but severe, slowdown in global growth amid a rapidly evolving—and growing—pandemic. The assumption from here is that the first half of the year, and the second quarter especially, is likely to look very, very weak for the global economy. But fiscal and monetary policy support—and the rapid resumption of activity as the coronavirus abates—should mean a rebound in growth in H2 this year.

Concerted, but hardly co-ordinated, central bank policy has strengthened over the past weekend, with the Fed slashing its key target rate 100bps to a range of 0-0.25% and relaunching QE; various other central banks also took rate or other policy action and there may be more to come. We expect the Bank of Canada to follow up on Friday's surprise 50bps cut with another ease to mimic the Fed shortly—and certainly before the scheduled mid-April meeting.

There are tentative signs that Fed action, in conjunction with other central banks, on swap lines has mitigated developing USD funding tensions to some extent, even if "normal service" has hardly been resumed. This development may moderate upward pressure on the USD that we noted last week could emerge if tensions in USD funding markets persisted. But equity market volatility remains elevated and renewed losses for the major US averages have perhaps only steadied so far today as investors hope for further evidence of G7 co-ordination on fiscal policy.

Bear markets come in all sorts of shapes and sizes and the generally accepted, standard definition—a 20%drop from the market peak—is a purely arbitrary indicator. Major bear markets in the US since the 1920s have lasted somewhere between 6 months and three years. Losses have ranged from the "bare minimum" of 20% to nearly 90% (in the case of the DJIA between 1929/1932). For the S&P 500, commonly-cited data for the average length of the bear market is 14 months and an average loss of around 33%. Bear markets are sometimes, but not always, accompanied by an economic recession which can slow markets from returning to more "normal" rates of return.

That might suggest that the worst of the equity market decline might already be behind us. But we think caution is warranted; the economic cost of global supply chain disruptions and the near shuttering of travel and hospitality services in many large economies—for a number of weeks still to come—is hard to calculate. Moreover, it remains to be seen if sequestration and isolation in China has managed to successfully contain the virus or whether it re-emerges once activity picks up again.

With so many issues still to be determined, we think caution is likely to remain the watch-word for investors and that is likely to mean investors continue to trade defensively. The JPY and CHF have been fairly reliable hedges against US equity

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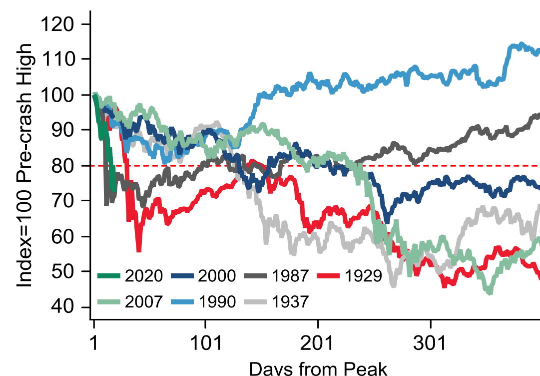
Major US Equity Bear Markets



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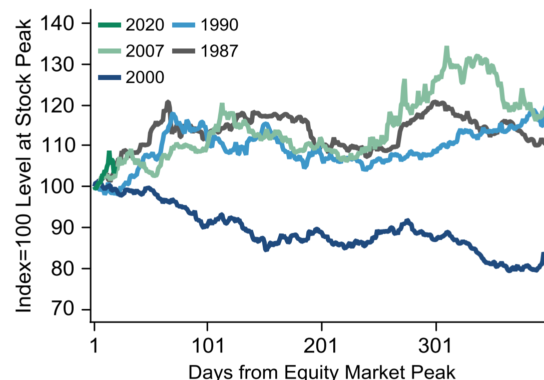
JPY Mostly Stronger in Bear Markets



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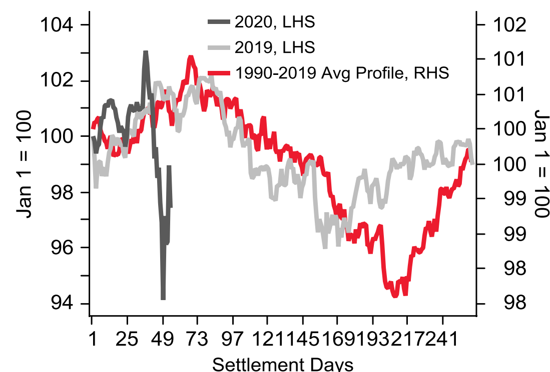
USDJPY - Seasonal Profile



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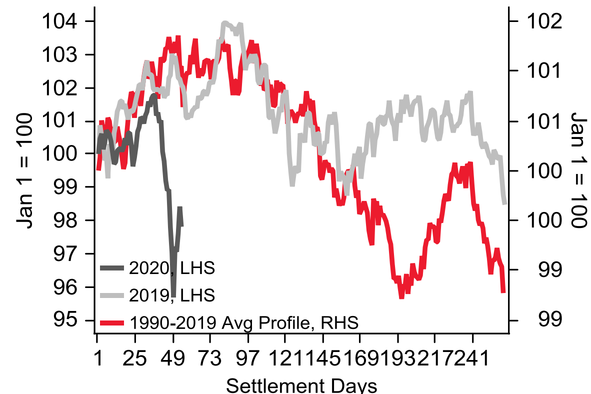
market weakness in the last 30+ years. On average since 1987's crash, the JPY has risen 10% to a peak against the USD in the first 60 days of the market setback. The CHF has risen 13% over the following 100 days of the initial market decline. Both the JPY and CHF may see demand through the spring an early summer enhanced by a fairly persistent and consistent seasonal bid versus the USD—which both the Bank of Japan and Swiss National Bank may be concerned by. Our forecast update released on March 11th calls for USD to ease to JPY100 through mid-year before edging modestly higher again.



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