Financial Market Weekly

MUFG UNION BANK, N.A.
ECONOMIC RESEARCH (NEW YORK)
CHRISTOPHER S. RUPKEY, CFA
MANAGING DIRECTOR
CHIEF FINANCIAL ECONOMIST
(212) 782-5702
crupkey@us.mufg.jp

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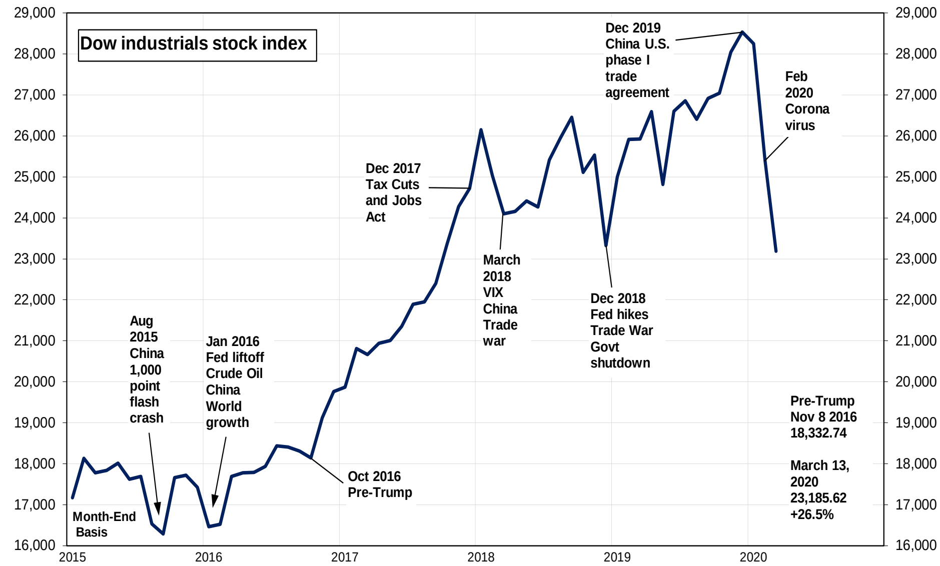
STOCK MARKET VALUATION



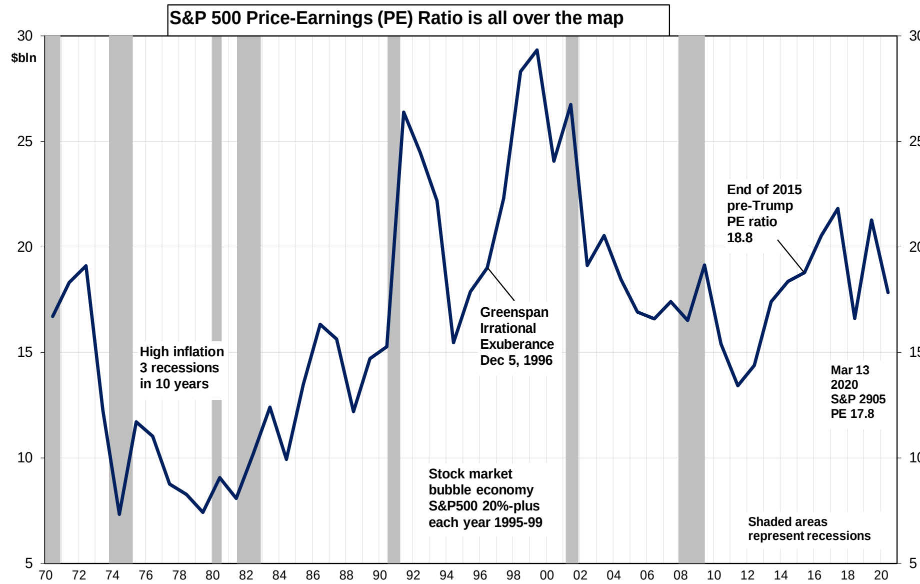
It's Friday the 13th and as good a day as any to take a look at the current value of stocks… if there is any. If you have any money left to care. The S&P 500 was down as much as 27.0% on Thursday from record highs in February, and closed Friday down 20.1% from the best level in history. It is true that polls show just 55 percent of Americans have money at play in the stock market. But it is also true that the stock market is one of the most leading indicators of the economy's fortunes. Starting in the early 1990s, 401K savings plans for retirement boosted the amount the public has at risk in the stock market. When the public loses money in stocks it could make them feel less wealthy and less likely to whip out the credit card and splurge. Corporations often pull back their spending on investment when a stock market sell-off reduces the value of their shares. If consumers and businesses (85 percent of the economy) both give up and reduce their spending, the economy can turn down and then it's a recession.

Dow industrials market sell-offs--10%-plus
Week ending Fridays

Chg %	Points	High	Low	High	Low	Reason
-15.1	-1909.7	7-22-11	9-23-11	12681.2	10771.5	S&P USA AA+, Fed sees "significant" downside risks
-11.9	-2170.2	5-15-15	9-4-15	18272.6	16102.4	China, oil, 1,000 point flash crash Monday, Aug 24
-10.8	-1936.5	11-6-15	2-12-16	17910.3	15973.8	Fed liftoff, China, $20 oil, world growth, Japan negative rates
-11.6	-3083.5	1-26-18	3-23-18	26616.7	23533.2	VIX-Linked Notes; China; Trade war(s)
-16.1	-4298.1	9-21-18	12-21-18	26743.5	22445.4	Fed hikes, 3.2% 10-yr, China war, Trump shutdown
-21.1	-6212.5	2-14-20	3-13-20	29398.1	23185.6	Coronavirus, oil price war

Valuation of stocks is not exactly easy like it is for the bond market, when there was a bond market, where yields are always propped up by the backbone of the Fed policy's overnight intererst rate: that's more theortical now given the week's plunge in bond yields to 0.31% on Monday with the Fed funds rate at 1.25%. Bonds were trading like penny stocks on Monday, where a $100 bond at one point would pay you just 31 cents interest this year. Before the Fed caved in late 2018, a $100 bond payed as much as $3.26.

Stock prices are based less precisely on company earnings. In some decades like the 90s investors will pay over 20 times earnings for stocks, and in some decades like the 70s investors pay less than ten times earnings. A wide range for value. Can drive a truck through the spread of investment advice on it.



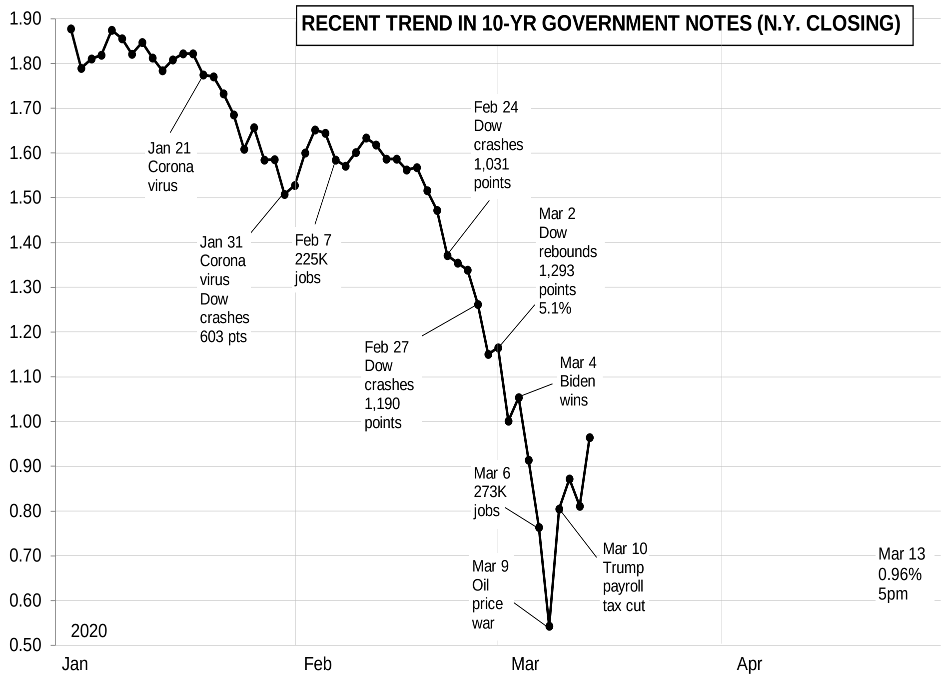
Here's ours. What turns a 20% stock market loss into a 50% loss? Stocks fell over 50% during the last two recessions. In 2008 the trigger seemed to be a government policy failure where Lehman was allowed to go bankrupt. Before Lehman on Friday, September 12, the S&P 500 had fallen as much as 23.8% from record highs to the low. The recession was from December 2007 to June 2009, and the Fed had cut rates from 5.25 precent down to 2.0 percent before Lehman. Stocks eventually hit bottom in March 2009 for a loss of 57.7%. What brought stocks back? The Fed tried to ride to the rescue with QE in March, but we prefer to think that investors finally saw value after stocks fell over 50% from the highs. Washington can't do everything. Eventually the market will come back.

The stock market bubble during the late 90s during the internet craze ended badly. This is the second time in the last two decades a 20% stock market loss turned in to a 50% loss. There was a recession from March 2001 to November 2001. The S&P 500 had fallen as much as 30.4% from record highs before 9/11. The Fed had cut rates from 6.5 percent down to 3.5 percent before 9/11. After 9/11 it fell as much as 39.4% from the March 2000 bubble high before recovering a little for a time. The final low came in October 2002, down 50.5%, after the Enron and WorldCom bankruptcies.

The S&P 500 fell 20.2% in December 2018 during the Federal government shutdown, 3% bond yields, trade war, Fed hikes. The S&P 500 fell 27.0% so far in 2020 at the worst point on Thursday. The outlook is simple. As long as there isn't another Lehman or 9/11 or Enron or WorldCom, the Thursday, March 12 low in stocks should hold with the S&P 500 total loss this time around of 27.0%. Guess it's never simple though. The economy hasn't even entered a recession yet as no one has lost their jobs. Therefore, no sense of how bad corporate earnings from the economy could be yet. Stay tuned. Story developing.

MARKETS OUTLOOK

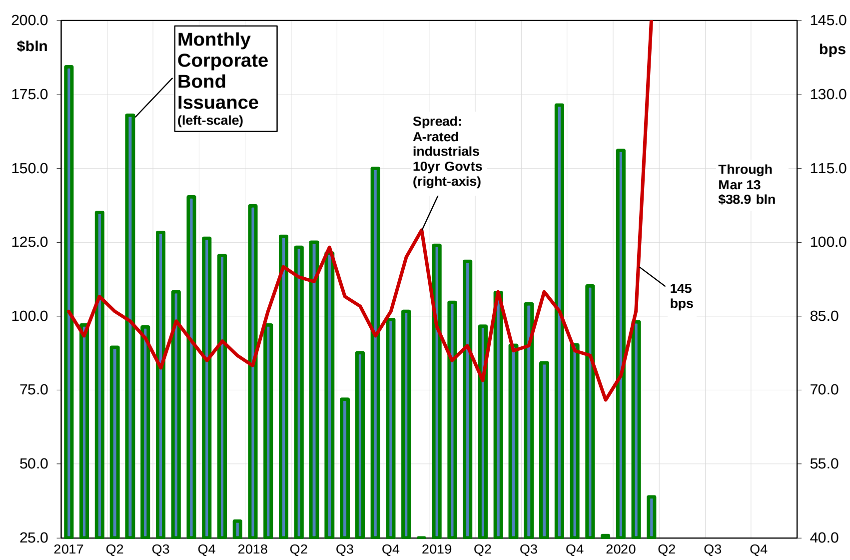
	29-Mar 2019	28-Jun 2019	30-Sep 2019	31-Dec 2019	6-Mar 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021
30-Yr Treasury	2.81	2.53	2.11	2.39	1.29	1.40	1.50	1.70	1.80	1.80
10-Yr Note	2.41	2.01	1.67	1.92	0.76	1.00	1.20	1.40	1.50	1.50
5-Yr Note	2.23	1.77	1.55	1.69	0.61	0.90	1.15	1.35	1.40	1.40
2-Yr Note	2.26	1.76	1.62	1.57	0.51	0.80	1.10	1.30	1.30	1.30
3-month Libor	2.60	2.32	2.09	1.90	0.90	1.00	1.10	1.10	1.20	1.20
Fed Funds Rate	2.50	2.50	2.00	1.75	1.25	1.25	1.25	1.25	1.25	1.25
2s/10s spread	15	25	5	35	25	20	10	10	20	20



The forecast above is suspended again. Obviously, a strange week for the bond market, and maybe the last week of its life. 10-yr Treasury yields closed 0.76% last Friday, bad enough, and was as low as 0.31% Monday (3am). An oil price war brought crude oil down to $27.34 and Dow stocks collapsed 2,013 points. On Friday, 10-yr yields closed back at 0.96%. The outlook depends on the Fed meeting next week, how much they cut interest rates. We need to know if Fed rates are going back to 0.25%, where it all started from before liftoff in December 2015. Maybe a 100 bps cut, who knows what Fed Chair Powell is thinking. Know shortly.

CORPORATE BONDS: STARBUCKS, TEXTRON, DUKE, ZIMMER BIOMET, AEP

Corporate offerings were $8.1 billion in the March 13 week versus $30.9 billion in the March 6 week. On Tuesday, Starbucks sold $1.75 billion 7s/10/30s. It priced a $750 million 2.25% 30-yr (m-w +25bp) at 165 bps (Baa1/BBB+). The specialty coffee retailer will use the proceeds to repay commercial paper borrowings, share buybacks, and for general corporate purposes. Corporate bond yields (10-yr Industrials rated A2) were 145 bps above 10-yr Treasuries Friday versus 103 bps last Friday.



FEDERAL RESERVE POLICY

The Fed meets March 17-18, 2020 to consider its monetary policy. They just cut rates 50 bps on Tuesday, March 3 to 1.25%. Now we are supposed to believe another big one is coming up at the regular Fed meeting to be announced on March 18. Come on in the water's fine. Join us. Washington sounds ready to drain the rates swamp. That's what Fed funds futures are saying. A "94 bps rate cut" is discounted. Is this an emergency? I know I am working from home, but what does a 75 bps drop in the Fed funds rate from 1.25% to 0.50% do exactly for Main Street, forgetting that it is a terrible decision for Wall Street. Fixed Income on Wall Street. 125 bps of rate cuts in March 2020 would rival the 125 bps Fed Chairman Bernanke delivered at the start of the Great Recession in the month of January 2008. Rivals the Bernanke massive rate cuts, except he started when they actually still had a policy tool the public believed in with the Fed funds rate at 4.25%. Even then, despite the early Bernanke cuts, the recession didn't end until June 2009 over a year later.

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	11-Mar	4-Mar	26-Feb	19-Feb	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2523.031	2502.624	2474.060	2451.688	479.782
Federal agency debt securities	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	1371.846	1371.846	1371.843	1385.784	0.000
Repurchase agreements	242.375	195.000	143.440	163.900	126.750
Primary credit (Discount Window)	0.011	0.001	0.013	0.005	23.455
Term auction credit (TAF auctions)	0.000	0.000	0.000	0.000	150.000
Asset-backed TALF	0.000	0.000	0.000	0.000	
Maiden Lane (Bear)	0.000	0.000	0.000	0.000	29.287
Maiden Lane II (AIG)	0.000	0.000	0.000	0.000	0.000
Maiden Lane III (AIG)	0.000	0.000	0.000	0.000	
Central bank liquidity swaps	0.058	0.048	0.044	0.067	62.000
Federal Reserve Assets	4360.0	4289.3	4206.4	4219.8	961.7
3-month Libor %	0.77	1.00	1.61	1.70	2.82
Factors draining reserves					
Currency in circulation	1818.957	1810.269	1800.040	1799.719	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	1.325	5.025	2.300	5.149	0.000
Reserve Balances (Net Liquidity)	1779.990	1735.005	1680.070	1659.021	24.964
Treasuries within 15 days	21.427	22.679	34.812	31.238	14.955
Treasuries 16 to 90 days	221.961	213.281	188.784	170.808	31.549
Treasuries 91 days to 1 year	378.403	367.820	355.980	361.944	69.272
Treasuries over 1-yr to 5 years	915.101	914.339	913.398	906.588	170.807
Treasuries over 5-yrs to 10 years	327.906	326.323	325.382	325.396	91.863
Treasuries over 10-years	658.232	658.181	655.702	655.715	101.337
**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08					

Could the Fed cut rates this aggressively again? At least the economy was in a recession when Bernanke cut rates at the start of 2008. There's no recession now, but all central bankers talk together all the time and we can't help but shudder that Fed Chair Powell will follow the departing Bank of England's Carney this week in throwing yields over the cliff. On Wednesday, the Bank of England cut the base rate 50 bps back to the rock bottom level of 0.25%. If other central bankers in the world are stepping up and doing what it takes to fight the coronavirus slowdown, how can the Federal Reserve in Washington stand back? Especially given the President's encouragement. Or maybe G7 has coordinated more action to come. We guess Powell is going. 75 bps on March 18 which is a 125 move for the month. Why not go 100 bps and return rates to 0.25% where they were before the December 2015 liftoff? Maybe they will do an ECB which somehow managed to announce three separate rate cuts starting from the 0.25% level in 2014 (to 0.15, then 0.05, then ground zero 0.00). Meanwhile, the Fed has already done some more QE or provided some needed liquidity for funding markets. Total assets Wednesday were $4.360 trillion up from $4.289 trillion the week before. We guess Fed officials are foaming the runway Lehman-style thinking the banking system needs the money and liquidity although when the New York Fed offered a trillion term repos on Friday, the Street only took $41 billion. Stay tuned. Story developing.

Last Fed Rates Forecast Forever?

Fed Individual Forecasts					
Fed funds rate at year-end					Longer
Votes	2019 End	2020 End	2021 End	2022 End	run
1	1.625	1.625	1.625	1.625	2.000
2	1.625	1.625	1.625	1.875	2.250
3	1.625	1.625	1.625	1.875	2.250
4	1.625	1.625	1.625	1.875	2.375
5	1.625	1.625	1.625	1.875	2.500
6	1.625	1.625	1.875	1.875	2.500
7	1.625	1.625	1.875	2.125	2.500
8	1.625	1.625	1.875	2.125	2.500
9	1.625	1.625	1.875	2.125	2.500
10	1.625	1.625	2.125	2.375	2.500
11	1.625	1.625	2.125	2.375	2.500
12	1.625	1.625	2.125	2.375	2.500
13	1.625	1.625	2.125	2.375	2.750
14	1.625	1.875	2.125	2.625	2.750
15	1.625	1.875	2.375	2.625	3.000
16	1.625	1.875	2.375	2.875	3.250
17	1.625	1.875	2.375	2.875	
Median	1.625	1.625	1.875	2.125	2.500
Meeting	Dec 19	Dec 19	Dec 19	Dec 19	Dec 19

OTHER ECONOMIC NEWS THIS WEEK

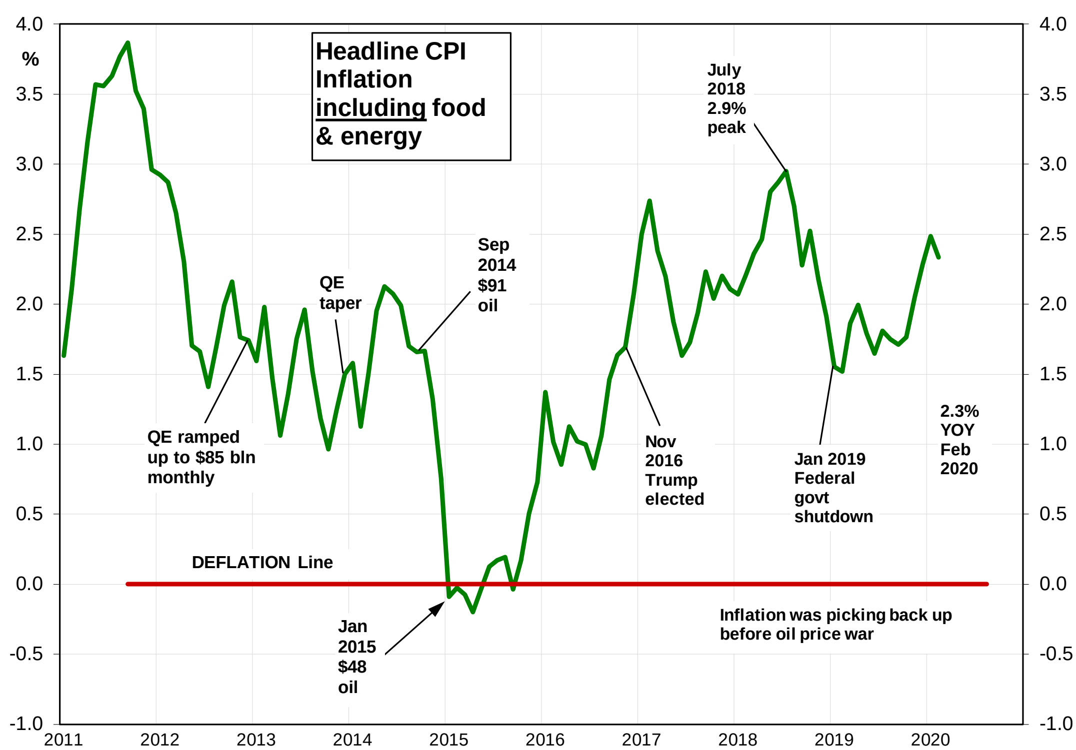
No deflation yet from the spreading coronavirus fears for the economy (Wednesday)

Breaking economy news. CPI inflation for February. Headline CPI rose 0.1% and is up 2.3% from last year. Core CPI inflation rose 0.2% and increased 2.4% year-on-year. No deflation yet with inflation over 2% where deflation means at least -0.1%. At least something is increasing at the Fed's 2% target because economists fear growth will slow to 1% which means they fear but won't forecast a recession. The Fed funds rate is just 1.25 percent and the market is betting on a 75 bps rate cut to 0.5 percent at next Wednesday's Fed meeting. And the market must know what it is talking about.

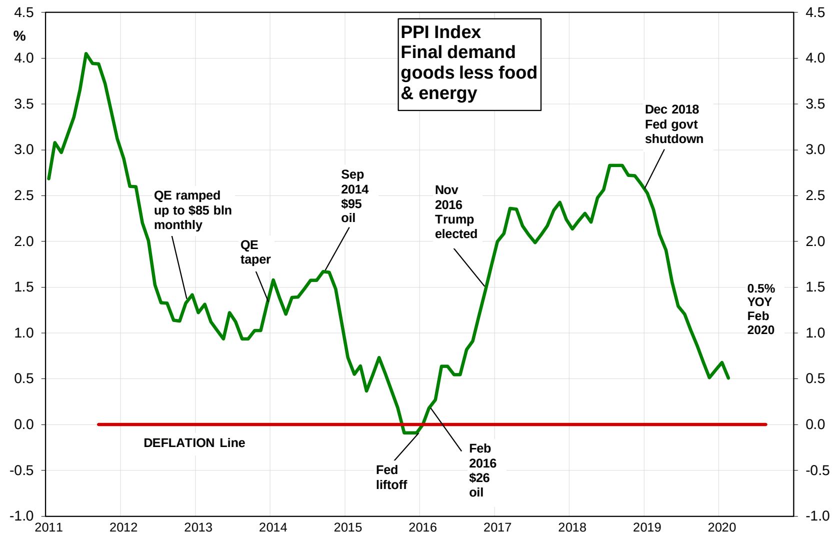
Inflation may be just 2.3% overall, but some important categories near and dear to Americans' hearts are beating faster. Medical care services are up 5.3% the last year and shelter, the cost of the roof over your head, is 3.3% higher than it was a year ago.

Net, net, there's still inflation in February but maybe not for much longer with the spreading coronavirus fears darkening the economic outlook. The public's reaction to the virus literally has the potential to shut down the economy with travel interrupted and business meetings cancelled. The wheels of the economy can't continue to turn as fast if the whole country avoids social interaction and tries to live online through the Internet. With less store traffic, merchants may have to actually cut prices instead of raising them.

Inflation today, but maybe not as much tomorrow as social distancing keeps Americans at home instead of out at the shops and malls. Stay tuned. Story developing. If you are reading this from your smart phones out on the street, please return to your homes. It's not safe out there. No deflation yet from the spreading coronavirus fears for the economy, but it's coming. Bet on it.



Deflation at the producer level, but they are hanging onto their workers (Wednesday)

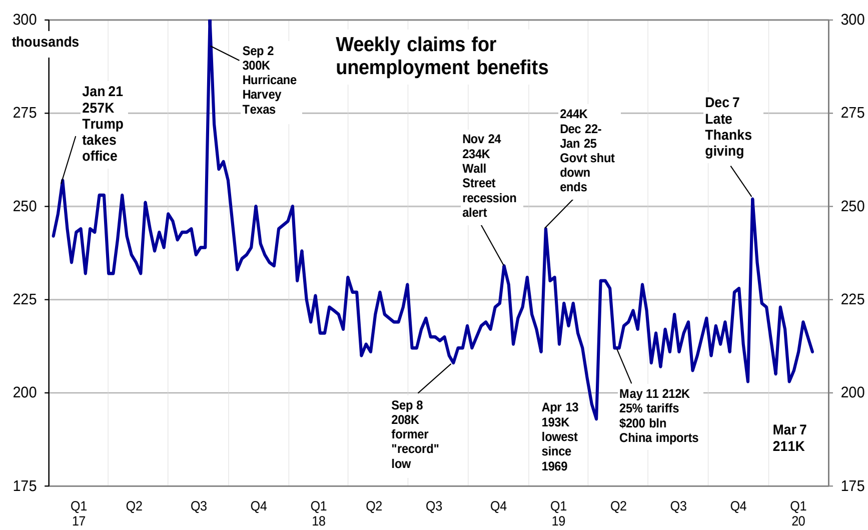


Breaking economy news. PPI inflation and the weekly jobless claims statistics if you can take your attention away from plunging stock markets and Fed funds futures clamoring for a 100-bps rate cut next Wednesday. 100-bps should do the trick we would think. Just what the economy needs.

First off, there's no recession unless we say so, we mean unless companies take the drastic step of firing workers because they don't have the sales, orders, revenues, profits to support them. That isn't happening in the March 7 week, two weeks into the stock market drop on coronavirus fears, as jobless claims fell 4 thousand to 211 thousand for the week. Completely normal for now. We wish the Fed had waited for the first 50 bps rate cut last week until the economy was in a downward spiral before shooting what turned out to be blanks at the stock market rout. Wait for Wall Street's woes to infect Main Street's economy is the proper way to run monetary policy. Pay no attention to the tweets behind the curtain.

Final demand PPI prices for goods got walloped by a 0.9% drop in February with the BLS estimating 60 percent of this was energy related. Goods prices minus foods and energy fell 0.1% in February, the first whiff of deflation since a 0.1% decline in September.

Services prices are harder to measure at the producer level, but the margins for apparel, footwear and accessories retailing dropped 11.7%. Hotels and airline passenger services also moved lower and this is still February.

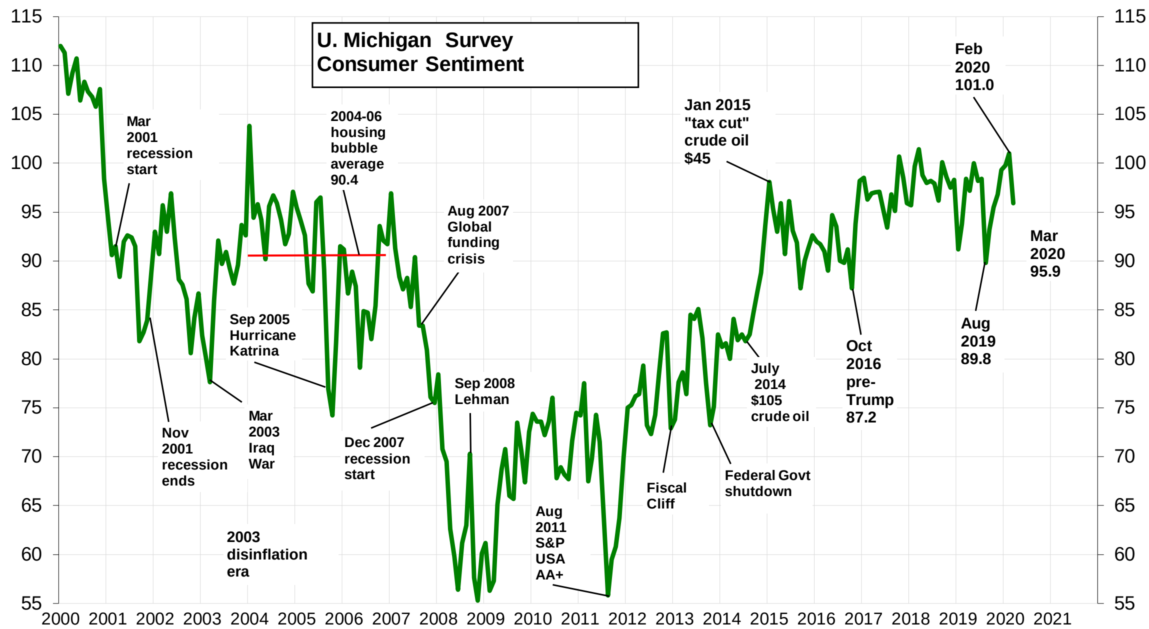


Net, net, producers were facing weakness in the prices they can charge for their goods and services already in February before the gathering storm clouds on the horizon. The good news is that the economy is still on the edge of the cliff facing recession and won't go over the cliff and actually turn down into negative growth until unemployment starts to increase, and so far, companies continue to hold on tight to their work forces despite the mounting fears posed by the spread of the coronavirus. Who knows for how long of course as the NBA is suspending its season with maybe the NHL close behind, so at some point service industries where the public gathers are going to have to cut back on their workers. There's deflation at the producer level, but the good news is they are holding onto their workers for now. Stay tuned. Story developing as the stock market churns.

Consumers are down but not completely out... yet (Friday)

Breaking economy news. The consumer sentiment index fell back sharply to 95.9 in early March from 101.0 in February. Another economic statistic starting to feel the effects of the spreading coronavirus. If the stock market cannot rally back from yesterday's recession-causing 27.0% high-to-low drop in the S&P 500 this year, then consumer confidence will really take a dive next month when the retiring baby boom generation reads their 401K statements a little more closely.

Net, net, Wall Street has finally come to Main Street with consumer confidence taking a hit in the face of unprecedented market turbulence. Loss of confidence is exactly what we see at the start of a recession and it will be a miracle if the country can avoid one as social distancing to stop the spread of the coronavirus forces many businesses and consumers to shut down and go into hibernation for the next month.



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