MIRABAUD Asset Management

FLASH NOTE

4 March 2020

FEDERAL RESERVE MEETING

FED'S SHOCK THERAPY UNLIKELY TO BE EFFECTIVE

STRATEGY TEAM

- The US central bank decided in an unscheduled meeting on 3 March 2020 to **cut the target range of the federal funds rate by 50 basis points**, to 1.00-1.25%.
- In an **unanimous decision**, the FOMC judged that risks to the outlook have changed materially and that an immediate response was needed now.
- As the coronavirus is at the heart of a broader supply shock, we think lower policy rates have only a limited impact on activity. But given strong signaling by the Fed, we **expect two further rate cuts until this summer.**

The Interest Rate Decision. The US Federal Reserve lowered the target federal funds rate by 50 basis points, to 1.00-1.25%. This decision has been taken unanimously, two weeks before the initially scheduled meeting of mid-March. The last unscheduled meeting took place during the great financial crisis in 2008, when the Fed also announced an emergency rate cut.

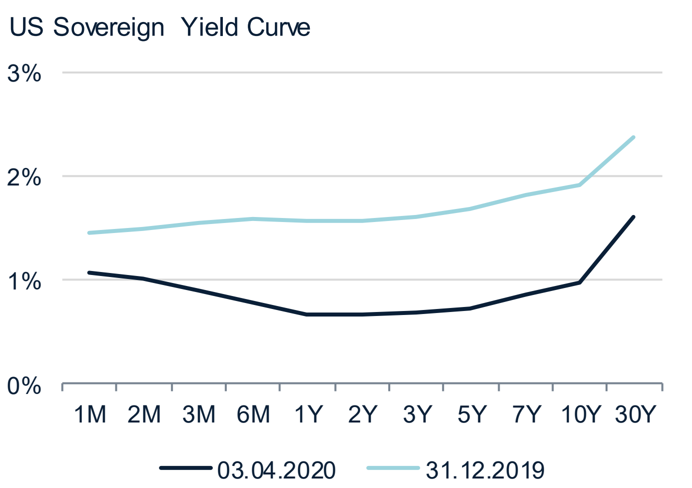
The Rationale. Fed Chair J. Powell stressed that economic fundamentals of the US economy remain solid, but that the risks to the outlook have changed because of the spread of the coronavirus, that brings new challenges. The FOMC recognized that the negative impacts of the coronavirus are in their early stage, but that hotel and traveling businesses are already reporting difficulties in the US. **With this pre-emptive cut, the Federal Reserve plans to support the economy through a boost in household and business confidence, and to avoid a tightening in financial conditions.**

Our take. This decision will have very little impact on real activity in the short term, and an emergency cut was not needed, in our view. Indeed, the coronavirus outbreak causes supply-chain disruptions due to containment measures taken by governments. A more expansionary monetary policy cannot fix a supply shock, only help cushion demand shocks. Regarding effects on financial markets, **we think that this emergency cut raises confusion, increases negative market sentiment, while raising uncertainty on the Fed's reaction function**. Going forward, and given strong communication by Fed officials**, we expect further rate cuts to follow**, with a high likelihood of a further 25 basis points cut to be announced at the next (scheduled) March 18 FOMC meeting. While other central banks might similarly act, **we expect the ECB and the SNB to remain on hold for the time being**.

Market Reaction. In bond markets, the reference US Treasury 10-year yield registered a new all-time low, falling below 1%. In equities, the S&P 500 closed down nearly 3% on the day, while the US dollar depreciated relative to the Euro.

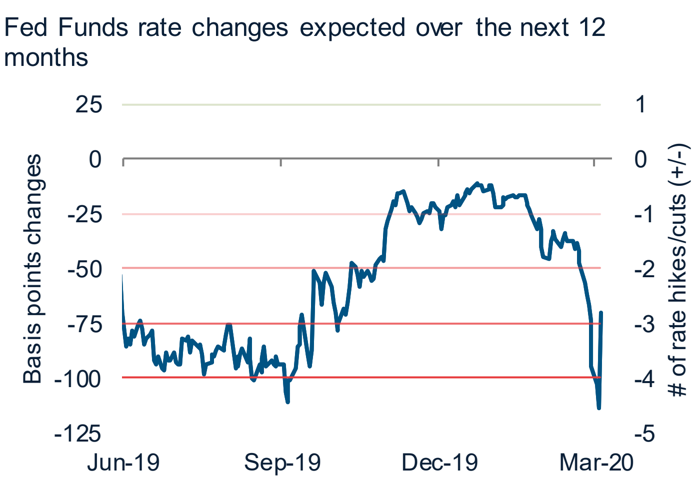
Asset Allocation. We remain cautious as the market correction is taking place at a time when valuations were historically high and expectations of earnings growth will continue to be revised downwards. **We are maintaining our hedges in our US and European equity positions**. While we keep our neutral outlook on EUR/USD, we expect in the near term a softer greenback, due to the dovish stance of the Fed and the limited room for further easing in the Eurozone.

THE US SOVEREIGN YIELD CURVE HAS SHIFTED DOWNWARDS



Sources: Federal Reserve, Datastream, Mirabaud Asset Management

ANOTHER 3 RATE CUTS ARE EXPECTED IN THE NEXT 12 MTHS



Sources: Datastream, Mirabaud Asset Management

Mirabaud Asset Management (Suisse) SA

29, boulevard Georges-Favon CH-1204 Geneva T +41 58 200 60 00 F +41 58 200 60 01
www.mirabaud-am.com