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Five thoughts before starting the week.

I write this note in English, in deference to all my colleagues at Sigma in Tel Aviv, who are working today.

1. **Why the Fed cut rates by 50 bp?** The collapse in oil prices lowering US inflation expectations allowed the Federal Reserve to not wait for its scheduled March meeting to cut short term rates. Thus, the Fed decided to do it before the impact of the coronavirus show up.

2. **Market reaction**: Investors were frightened at the measure of the Fed cut between two meetings, but we believe (as suggested before) that the Fed simply took advantage of the collapse in the expected inflation (measured by the break even rate) to act rapidly. Admittedly, the VIX index hit its highest rise in intraday trading since January 2009, and the most striking was perhaps that the 10-year US treasury yield hit a new record low of just 0.76%, being in full panic mode. At current levels, bond yields are foreshadowing an economic ice age.

3. **Meanwhile, what's going on in China? How much Chinese workers have lost?** The official number of new coronavirus cases in China dwindles to just a few dozen a day, and investors have left to count the economic costs. Chinese workers have lost on average 3-4% of annual household income. However, the middle class, which drives consumer spending, is more insulated. There is therefore a fair chance that demand will recover strongly once the emergency is over. Investors seem to be looking beyond the prospect of catastrophic 1Q earnings figures.

4. **Why onshore equity investors in China are not overly troubled?** Following post new year sell-off, the CSI 300 index has now rallied 12%. The Shenzhen composite index, which is more skewed towards smaller private sector companies, is up 19%, indicating that the rally is broad based, and not the result of a government price-keeping action. <u>This is important, as the wide breadth of the rally argues for its sustainability.</u>

5. **A new war in the oil & energy market? Can oil price retest 2016´s lows?** On Friday, Russia refused to sign up to an additional 1.5mn bpd output cut proposed by Opec. In response, Saudi Arabia threatened to increase its production by as much as 2mn bpd in a bid to defend its market share. The result of this disagreement was the collapse in the price of crude oil (-10% to US$41.28/bbl for WTI). Moscow clearly believes it is better placed to ride out the impact of a collapsing oil price on its revenues than the Gulf Arab states or cash-squeezed US shale producers**. This situation of low oil prices is good and bad at the same time.** Good because a low crude oil has

historically been a factor that fuels the appetite for global risk (It reduces operating costs, increases margins and profits, frees private liquidity). Bad because an oil at $26/bbl will inflict a great pain to the entire unconventional energy industry in the US, and probably causing bankruptcies across the US shale patch. All said, however, we consider that the most logical behavior among producing countries is that of an understanding (as it has been in recent years)if only to avoid the collapse in their reveneues.