

Daiwa's View

Continuing deterioration in investor sentiment

- President Trump testing positive for COVID-19 may be factor behind deterioration

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Daiwa Securities Co. Ltd.

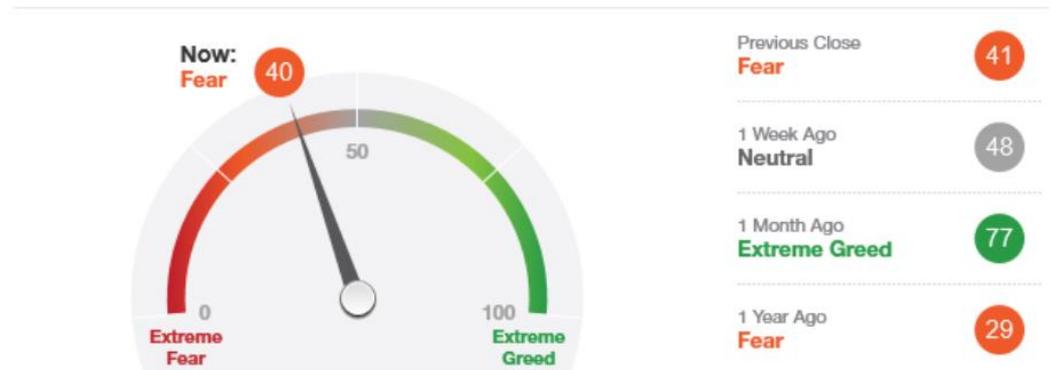
Trump testing positive for COVID-19 may be factor behind deterioration

Continuing deterioration in investor sentiment

At the end of last week, markets were volatile, reflecting the news of President Donald Trump tests positive for COVID-19. Although I always try to keep in mind that “unexpected things happen,” this news was a surprise. Recently, we have seen a series of unfavorable headlines, such as the [Tokyo Stock Exchange's cash stock trading halt for an entire day on 1 October](#), and the Commodity Futures Trading Commission/Department of Justice's release on 29 September regarding the imposition of \$920mn in monetary relief on JPMorgan Chase's illegal trading on precious metals/Treasury futures (spoofing). In particular, the latter probably reminded many people of “the London Whale” scandal, in which JPMorgan Chase's CIO division booked a large amount of losses on CDS transactions in 2012 in the midst of the European debt crisis.

The CNN's Fear & Greed Index, an indicator for investor sentiment, worsened to a “fear” level at the end of last week, although I do not think this happened because of the aforementioned factors alone. Given the fact that the index was at an extreme greed level one month ago, we can say that investor sentiment has worsened sharply. As investor sentiment swings easily, accumulation of bad news may delay a recovery of sentiment.

CNN's Fear & Greed Index



Source: Extracted from CNN website.

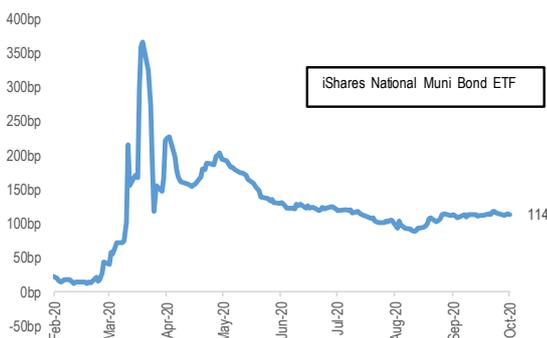
Last updated Oct 2 at 7:00pm

One interesting point when observing the market trends since the announcement of Mr. Trump's infection is that market reactions were lower stock prices/lower bond prices (= selling all risk assets). It is easy to understand the story envisaged by the bond market—"victory of the Democratic Party (higher chance) → large additional economic measures (deterioration in public finance) → higher yields." Meanwhile, the stock market appears to be aware of the tax hikes (corporate taxes, etc.) proposed by presidential candidate Joe Biden—i.e., lower profits due to fiscal austerity in the future, instead of positively viewing near-term additional economic measures. As the concept of time exists for bonds, there are good reasons to have a more short-sighted interpretation than for stocks. This time, bonds again reacted to near-term "bad news," and stocks showed reactions to long-term "bad news." These are precisely opposite to "cherry picking" reactions often seen under President Trump.

[The US jobs report](#), released at the end of last week, also might have clouded optimism. The figures in the private sector slightly exceeded the market estimates, but *Barron's* pointed out that the pace of employment recovery has already started to slow despite the need of another 10mn job gains to recoup jobs that were lost amid the pandemic. We also need to pay attention to the decline in employment in the government division, one factor behind the undershoot in the headline. It appears that the latest figure itself was largely affected by fluctuation associated with the census. Meanwhile, it is possible that we have started to see gradual materialization of Fed Chair Jerome Powell's concern (on 19 May) that restructuring at state/local governments would worsen the US economy. While local governments are facing unexpected additional expenditures to cope with the pandemic, a plunge in their revenues, mainly taxes, is almost certain. In state governments, which largely adopt a balanced fiscal policy, cuts in expenditures are likely to accelerate without support from the federal government.

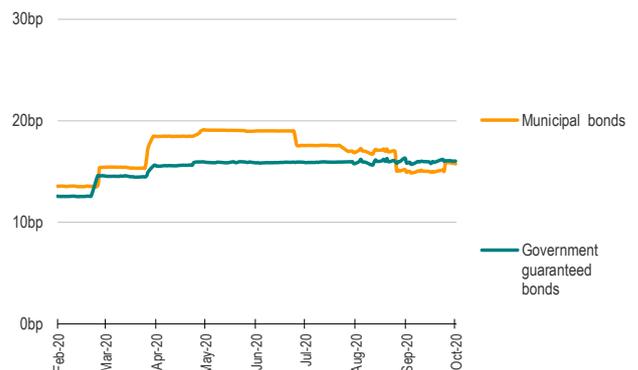
In this respect, the spread of the iShares National Muni Bond ETF, which consists of investment-grade US municipal bonds, vs. Treasuries still remains at a high level of 114bp, even though six months have passed since the start of the pandemic (chart below). If support from the federal government becomes insufficient, the aforementioned expansion in expenditures at municipal governments may cause the troubling solvency issue. Due to the existence of a solvency bottleneck, the terms of the Fed's support facility (Municipal Liquidity Facility: MLF) are necessarily strict (note: Fed [improved](#) terms to use MLF by 50bp on 11 Aug). Therefore, the Fed's support for local governments is weak. This fiscal issue for US local governments is different from Japan¹, where the spread of municipal bonds has been stable and low thanks to the distribution system of local allocation tax.

US Municipal Bonds: Spread vs. Treasuries



Source: Bloomberg; compiled by Daiwa Securities.

Japanese Municipal Bonds: Spread vs. JGBs



Source: Compiled by Daiwa Securities.

¹ Japanese gov't has official opinion that local government bonds should be repaid in line with initial terms/contracts except for case of agreement between parties.

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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

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[Fitch]

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- 1) As of 26 April 2016, Daiwa Securities Co. Ltd., its parent company Daiwa Securities Group Inc., GMO Financial Holdings, Inc., and its subsidiary GMO CLICK Securities, Inc. concluded a basic agreement for the establishment of a business alliance between the four companies. As of end-December 2017, Daiwa Securities Group Inc. owned shares in GMO Financial Holdings, Inc. equivalent to approximately 9.3% of the latter's outstanding shares. Given future developments in and benefits from the prospective business alliance, Daiwa Securities Group Inc. could boost its stake in GMO Financial Holdings, Inc. to up to 20% of outstanding shares.
- 2) Daiwa Real Estate Asset Management is a subsidiary of Daiwa Securities Group Inc. and serves as the asset management company for the following J-REITs: Daiwa Office Investment Corporation (8976), Daiwa Securities Living Investment Corporation (8986).
- 3) Samty Residential Investment became a consolidated subsidiary of Daiwa Securities Group Inc. effective 10 September 2019.
- 4) On 30 May 2019, Daiwa Securities Group Inc. formalized an equity/business alliance with Samty, and as of 14 June 2019 it owned 16.95% of shares outstanding in Samty along with convertible bonds with a par value of ¥10bn. Conversion of all of said convertible bonds into common shares would bring the stake of Daiwa Securities Group Inc. in Samty to 27.28%.
- 5) Daiwa Securities Group Inc. and Credit Saison Co., Ltd. entered into a capital and business alliance, effective 5 September 2019. In line with this alliance, Daiwa Securities Group Inc. is to acquire up to 5.01% of Credit Saison's total common shares outstanding (excl. treasury shares; as of 31 Jul 2019).

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- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥2 million per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

** The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

Corporate Name: Daiwa Securities Co. Ltd.

Registered: Financial Instruments Business Operator, Chief of Kanto Local Finance Bureau (Kin-sho) No.108

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