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2020 Corporate Cash Outlook

Guideposts for the New Year

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As the calendar flips to 2020, we're focused on fundamentals and how best to take advantage of the current rate environment. Read on for our thoughts.

Status Quo?

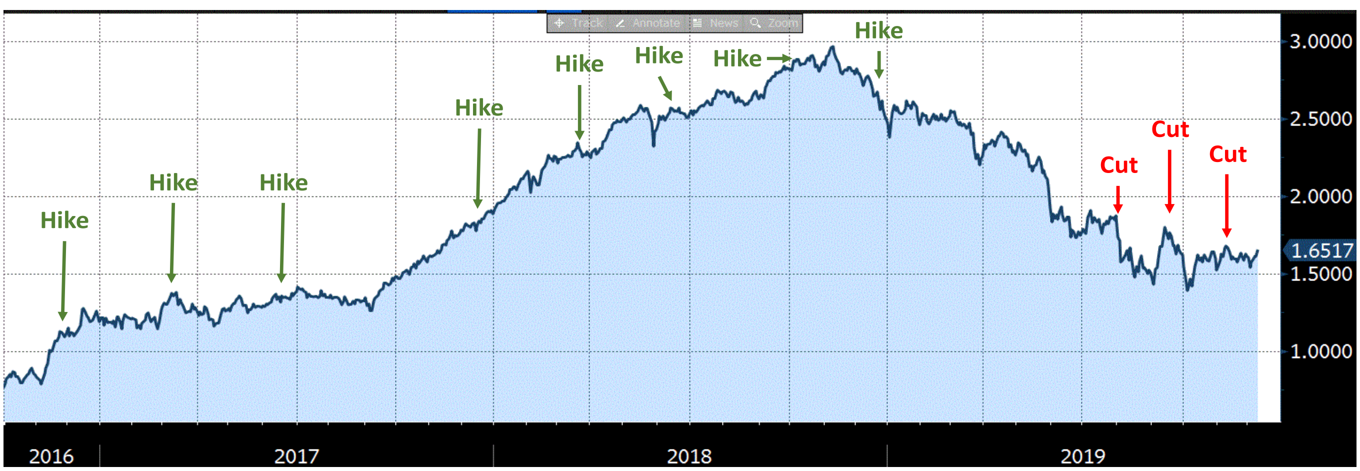
Despite a flood of new economic data and significant geopolitical news, there were remarkably few changes to the yield curve over the past two months. That's not the case when looking back over a longer timeframe – we began 2019 with every short-end maturity yielding well over 2% and a slightly- inverted curve. We're ending the year with a flatter curve with every maturity clustered around 1.50%.

Maturity	As of 1/1/19 Treasury Yield	As of 1/1/19 Slope	As of 12/10/19 Treasury Yield	As of 12/10/19 Slope	Change in
3 Mo	2.45%	-	1.54%	-	-0.91%
6 Mo	2.48%	0.03%	1.55%	0.01%	-0.93%
1 Year	2.61%	0.13%	1.55%	0.00%	-1.06%
2 Year	2.50%	-0.11%	1.65%	0.10%	-0.85%
3 Year	2.46%	-0.04%	1.66%	0.01%	-0.80%

Source: Bloomberg

Continuing recent patterns, the Fed has been trailing rather than leading markets. After bouts of severe volatility, 2018's 4 hikes were mostly reversed by 3 cuts in 2019 that were fully priced in by the market in the weeks leading up to them.

2 Year Treasury Yield vs. Fed Actions

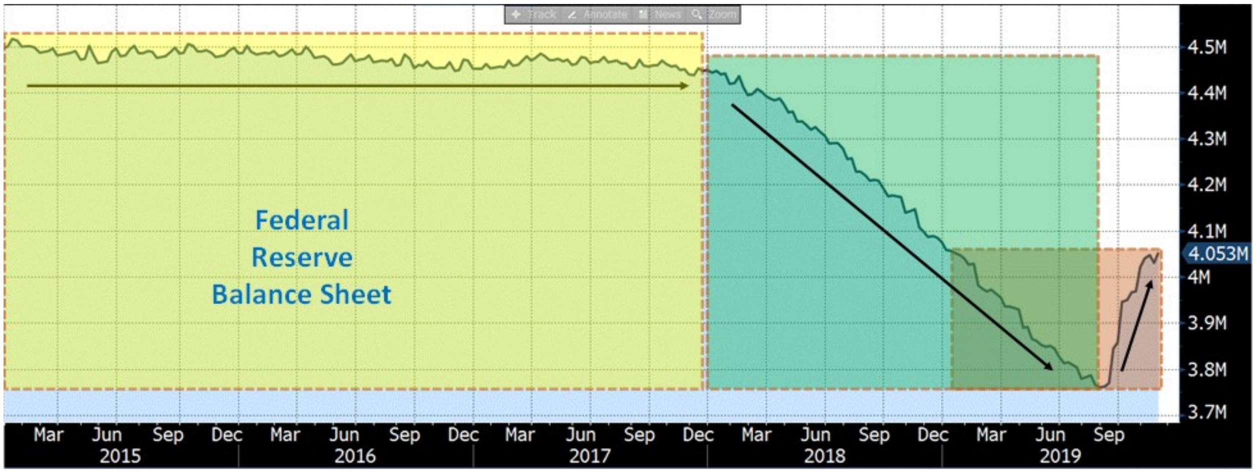


Source: Bloomberg

Moreover, after signs of visible stress in short-term funding markets, the Fed went further than simply calling off balance sheet normalization - its "emergency" repo purchase program has retraced over 40% of the preceding 1.5 years' worth of gradual runoff within just 3 months.

Federal Reserve Balance Sheet Over Time ($ Trillions)

Yellow = Maintaining Size, Green = Runoff, Red = Emergency Repo Program



Source: Bloomberg

Without opining on whether this qualifies as "Quantitative Easing 4", what's indisputable is that it's yet more accommodation in a global market that's already awash in easy money. Consider that the distortionary global negative debt overhang we previously highlighted remains largely in place - as of November 30th, there's still over $12 trillion in aggregate negative yielding debt and more than 400 million euros worth of negative-yielding corporate bonds. Large chunks of developed market yield curves consistently trade negative, such that American debt accounts for approximately 70% of all positive-yielding bonds in G10 fixed income markets.

Global Sovereign Rates As of 11/30/19

	3 Month	6 Month	1 Year	2 Year	3 Year
Australia	0.87%	-	0.76%	0.67%	0.65%
Belgium	-0.63%	-0.62%	-0.57%	-0.62%	-0.59%
Canada	1.64%	1.68%	1.69%	1.58%	1.56%
France	-0.65%	-0.62%	-0.57%	-0.60%	-0.58%
Germany	-0.65%	-0.63%	-0.63%	-0.63%	-0.66%
Italy	-0.35%	-0.22%	-0.17%	0.02%	0.24%
Japan	-0.17%	-0.21%	-0.16%	-0.17%	-0.18%
Netherlands	-0.76%	-0.69%	-	-0.63%	-0.65%
Norway	1.35%	1.19%	1.19%	1.24%	-
Spain	-0.56%	-0.54%	-0.56%	-0.38%	-0.36%
Sweden	-0.43%	-0.42%	-	-0.31%	-
Switzerland	-0.72%	-0.66%	-0.87%	-0.82%	-0.82%
UK	0.70%	0.74%	0.67%	0.54%	0.50%
US	1.57%	1.61%	1.59%	1.61%	1.61%

Source: Bloomberg

This global negative rate environment has driven foreign investors to increase their exposure to US bonds, with the increased demand driving our domestic rates lower.

Foreign Holdings of US Treasuries ($ Billions) vs. ECB Deposit Rate

Source: Bloomberg

Absent any signs of inflationary pressures or an unexpected about-face in strategy from new ECB President Lagarde, we expect this dynamic to persist. However, there are nascent signs of shifting views within the economic community – Sweden's Riksbank, traditionally a pioneering central bank, recently ended its multi-year negative rate policy and hiked to 0%. Stay vigilant for new developments in this space.

Outlook

In terms of economic fundamentals, our base case is the long-running expansion continues chugging along in 2020. Assuming Boeing gets its beleaguered 737-MAX flying and back under production sometime in Q2, we're penciling in trendline US real GDP growth of 2%+. Under this benign scenario, we expect rates to stabilize at current levels, where the front end of the curve is already balanced between continued modest domestic growth and the forces of global negative rates.

Turning to the Fed, it's clear they're biased towards lower rates. However, with M2 growth spiking (the 3-month annualized growth rate is >10%), unemployment at 50-year lows, and a robust housing market, the necessary ingredients for bringing about inflation's reappearance could emerge. As a result, we're on the lookout for inflationary pressures increasing before year end.

> ***Recall that the Fed is likely shifting from a static to an average inflation target – rather than continuously seeking 2% inflation, they'll now pivot towards tolerating the data "running hot" for a while to compensate for a decade of sub-2% readings. The practical upshot is they're likely to stay accommodative longer than prior historical experience would suggest.***

If inflation remains anemic, the global wave of monetary accommodation will support rising equity prices (via multiple expansion) and keep yields tightly clamped down. But if inflation takes an unexpected leg higher, look for the market to once again front-run the Fed and reprice rates of its own accord, shifting the curve higher and steeper. The scale and pace of the market's jumpy reaction could be larger and quicker than anticipated.

The other risks to this outlook are centered around politics. We can't ignore the runup to the 2020 election, since several plausible presidential candidates are explicitly promoting reform agendas that threaten to upend key pillars of the current market-based economic system. Naturally, it's far too early to gauge market impacts.

We're also keeping a close eye on developments in the US-China trade war, where our standing prediction for a substance-light "Phase 1" deal appears to be materializing. Although it's a welcome *détente*, we believe the overarching dynamic of global trade decoupling is primed to continue. This would clearly push the Fed towards additional accommodation.

Current Strategy

We're still extending durations and keeping weighted-average maturities near their limits (targeting at least 80% of their maximums). The global negative debt overhang coupled with an accommodative Fed are keeping domestic rates lower than what favorable US economic conditions would otherwise support. Given the likelihood the distortionary downward pressure from overseas fund flows will remain in place, the priority should be to continue extending maturities. Those portfolios with fresh cash should ladder maturities with an emphasis on the longer end of their maximum maturity constraints.

We look forward to helping you achieve your cash management goals in the new decade. Happy holidays and a joyful new year to all.