March 20th, 2020

ASK FORSTRONG:

HELLO FISCAL STIMULUS, WE'VE BEEN EXPECTING YOU

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Speed Read:

- It took a global pandemic, but the fiscal lever has, at long last, been decisively engaged.
- More stimulus is likely in the next month than during the entire 2008-2009 global financial crisis.
- A sharp economic recovery will emerge in the second half of 2020. Risk assets should rally well in advance of this.

It took a global pandemic, but the fiscal lever has, at long last, been decisively engaged. The collective rush is almost audible as governments everywhere scramble to activate the switch. A growing list of countries are now making announcements to counter the impact of coronavirus. Amid crisis, no amount seems too large. Spain initiated spending equivalent to 25% of its GDP. The UK pledged "wartime" funding. Even Germany — long stuck in an ideological logjam — has abruptly broke free.

The era of massive fiscal spending arrived fast and furiously. Suddenly, the world has changed. It was not an easy path to get here. 2008's global financial crisis ushered in a long era of stubborn prudence. Deleveraging, austerity and balanced budgets were in vogue. Governments flatly refused to engage the fiscal lever in a meaningful way. As such, central bankers were forced to carry the entire policy burden.

Debates raged over the efficacy of this approach. Central bankers grumbled the loudest, becoming the world's lead fiscal evangelists. Their message? We have done enough. The simple monetary lever that once existed has been replaced with a comprehensive dashboard of quantitative easing, negative rates, and a widespread enthusiasm to experiment with other features. The central banker cockpit is now fully equipped — but the ammo is spent. It's time for fiscal action.

Keep in mind, all this happened before the world ever heard about coronavirus. Before then, slow growth was the world economy's leading adversary. What a simple time. Now policymakers are facing a far fiercer fight: a fast-moving enemy that threatens lasting global economic

impairment.

Looking ahead, what can we expect? First, fiscal stimulus will be enormous. Governments have declared war on COVID-19. Truly, war-time measures are at hand. Just as in physical combat, there are no cost limits that will handicap victory. More stimulus is likely in the next month than during the entire 2008-2009 global financial crisis.

Next steps seem clear. Governments need to provide blanket assurances to their citizens and business for lost incomes and revenues. That means a guarantee of unlimited fiscal compensation. This can take many forms, including outright fiscal transfers or long-term zero interest rate loans to business. Fortunately, the legacy of 2008's crisis now makes this highly feasible, offering governments unlimited financing with near-zero borrowing rates, low inflation (for now anyway) and an almost universal tolerance for experimental policy.

Coronavirus has turned daily life upside down. The same will happen to orthodox economic ideas. With real incomes and revenues rapidly disappearing, ready solutions are needed now. This allows for the emergence of radical ideas — bazookas, helicopters and a more formal alliance between monetary and fiscal policy.

However, the focus of these policy attacks and field maneuvers are necessarily changing. The attention will now turn to income support and replacement. This is different from the post-2008 crisis period, where policymakers focused on asset prices and monetary liquidity.

Crucially, the impact of fiscal thrusts is also far different than monetary stimulus. Most misread the transmission dynamics of QE since it was introduced in 2008. What should be well known by now, is that available liquidity or lower rates do not automatically lead to more credit creation and higher inflation (this is the classic "pushing on a string" metaphor Keynes originally used during the 1930s depression). Monetary policy was largely unsuccessful in producing a private sector credit re-leveraging.

Fiscal stimulus is different altogether. Importantly, the transmission effects are much more direct, boosting consumption, investment and liquidity. More money immediately enters circulation. Inflationary pressures increase.

This makes the period directly ahead very interesting. Assuming the coronavirus lockdown is over in the first half of this year (our base case given the positive trajectory of other countries that confronted the virus earlier), a sharp economic recovery will emerge in the second half of 2020. The amount of stimulus policies — checks in the mail to virtually every household, unlimited financial market support, etc. — will be so large that demand and consumption will surge.

All this now defines the future. And, if political history is any guide, many of these temporary policies will become permanent. Once turned on, fiscal taps will not be shut off easily.

Investment Implications

Fiscal stimulus is not a vaccine for a public health crisis. In fact, more economic activity in the short run will only accelerate the spreading of coronavirus. But zero rates and liquidity injections are still a necessary palliative to prevent financial systems from collapsing. Fiscal measures designed to support recovery should wait until the virus is under control.

But the most important number for investors right now is not the amount of stimulus, but the rate of new infections. Any positive news on this

front will loosen coronavirus's grip on the public consciousness.

Investors fumbling around for the right historical analog will come up empty-handed. It is not 1929, 1987, 1999 … and certainly not 2008. This is 2020 and it is new terrain. Our investment team still maintains that coronavirus is a temporary demand shock, rather than a trigger for a longer-running depression. Policy has shifted to a "whatever it takes" approach to dealing with the pandemic. The global banking system is well-capitalized. And, most importantly, for the world's largest economies (i.e. the Eurozone and the US) no major global imbalances exist. This means systemic damage that would take years to work through can be avoided (whether a capital spending overhang like 1999 or consumer housing leverage like 2008).

Under this view, investors should be looking across the valley. Now is the time to be opportunistic in what has become a historic financial panic. We will report back early next week with specific actions our team is taking in client portfolios. In the meantime, stay globally diversified, do your part to flatten the curve and take care of your family. We will see you on the other side.