DOUBLELINE® CAPITAL LP

Jeffrey Gundlach - Thought Leadership

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It has been kind of a perfect storm to the downside with the oil shock and the business standstill created by COVID-19. Is this 2008 all over again? No, it's worse because of the more compressed time frame. Volatility and price discovery are moving so much more quickly with greater severity. There aren't pools of distressed capital waiting to buy previously highly rated securities like we had in 2008, when there was time to raise funds and wait for markets to drop. Not to mention there is no dealer liquidity to help stem losses. Non-dealer inventory of corporate bonds is over $10 trillion, five times the size it used to be, with ratings much worse than in the past. As I've been warning, now is very different in terms of stocks and bonds moving down together unlike recessions in the past.

The economy was already weakening going into the virus so we are going to have a very substantial negative GDP print given the decimation of the restaurant industry, travel industry, hotel industry, small businesses, and a rise of layoffs and unemployment claims. Some industry leaders are calling for negative 10% GDP for 2Q. If the unemployment rate goes above its five-year moving average, which I think will happen soon, it would further corroborate that we're in a recession. I now put the probability of recession at 90%.

There's a lot of illiquidity with prices moving all over the place across asset classes. The stock market is in a world of hurt, corporate bonds are down 12-15% year-to-date, dollar emerging market funds are down about 7% and losses are much worse in local currency terms. The bid ask spread in parts of the commercial paper market is 40 basis points. That's one of the reasons why the Fed is showing up. It started with the growth in the repo facility but now they fully admit we're doing Quantitative Easing (QE4) to the tune of $700-$800 billion which is likely not enough. They've cut Fed Fund rates down essentially to zero in under a week which is a clear indication we're not going back to anything resembling "normalcy." Natural market forces would cause a big steepening of the yield curve with the long end moving up, which would start a vicious cycle: Economy weakens, leads to more stimulus, leads to more bonds, leads to higher interest rates, leads to weaker economy. Rinse and repeat. The Fed may have to buy the entire Treasury bond market and perhaps beyond. The annual growth of the national debt was already 6.5% of GDP going into this. With a $1 trillion stimulus package, and growing, the national debt will grow by something around $3 trillion. We're talking about the national debt growing at 15% of GDP. There will be a lot of bonds to digest at a time when credit bond investors are already reeling.

The amount of corporate bonds is so large it is intensifying economic weakness. I mentioned the $10 trillion in corporate bonds. In my "Just Markets" webcast in January, I warned about BB-rated corporate bonds because the spread between the BB and BBB reached the narrowest level of compensation in history. It seemed obvious BB's were not going to perform and now they're down over 15% year-to-date and spreads have massively widened out. Downgrades are coming "Fast and Furious." We're seeing bad performance in the Investment Grade Corporate Bond ETF. In fact, that ETF is dropping at the same rate as the high yield ETF which implies a lot of these bonds are going to get downgraded to junk. The high yield market looks like it's screaming recession. You know there are underlying issues when the ETF and the index it tracks are pricing differently. With fast moving markets, ETFs are actually priced more accurately in real time while indices are lagging and overpriced.

With regard to government bailouts, it's going to be a tricky process as to how they all get implemented. There is great potential for corruption. I don't think the American people are going to be accepting of the big businesses (airlines, movie theaters, hotel chains, etc.) getting bailouts while local businesses are being shut down and unemployment soars. I look for social unrest and something approaching hatred of "Stock Buyback America."

THOUGHTS ON THE MARKET

U.S. Dollar (USD) - Has had a big move up but the momentum is terrible. Gold has gone to new highs in all currencies except the U.S. dollar. There are two ways to interpret this: 1) U.S. needs to catch up; or, 2) it's a massive divergence that is actually telling you something deflationary. With all this we still have not gone to new highs in the dollar.

Interest Rates - Backed up because the went to a panic low that was completely momentum-based. With stimulus by the Treasury department and growing deficits we will see supply pressure. This supply along with helicopter money is the worst possible set-up for the 10-year. You're not getting enough compensation for owning the 10-year. The long end has been rising so the Fed is ramping up to avoid interest rate pressure from negatively affecting the economy. I'm not going to buy Treasury bonds now.

Stock Markets - I have been recommending international stocks, certainly emerging markets stocks ex-China for a while now. This has been working well. The U.S. was the best performing stock market because of buybacks pushed stock prices up in spite of increasing corporate indebtedness. That works until it doesn't. That's what's happening now in the corporate bond market. These same companies that are going to be asking for a government bailout levered up buying back their stock. Why should tax payers bail them out? This is going to be a problem for main street America.

Gold - Gold rose to $1700 but is now selling off. I think it is in a consolidation mode right now. Difficult for anything to go up in price in this liquidation environment.

Oil - Saudi's "power play" against the Russian's refusal to stop production just made matters worse. Saudi ramped up production driving down prices and causing tremendous global pain. Trump talking about buying oil for the strategic reserve only means more bond issuance, more money printing, more stimulus.

DEFINITIONS

COVID-19 – A disease caused by the 2019 novel coronavirus.

Quantitative Easing (QE): A monetary policy whereby a central bank buys predetermined amounts of government bonds or other financial assets in order to inject money directly into the economy.

Gross Domestic Product (GDP): The amount of goods and services produced within a given country/territory.

Investment Grade Bond ETF – iShares iBoxx Investment Grade Bond ETF (LQD);Benchmark: Markit iBoxx USD Liquid Investment Grade Index, Fund's prospectus may be obtained by calling 1-800-474-2737 or by visiting www.ishares.com or www.blackrok.com.

High Yield ETF - SPDR© Bloomberg Barclays High Yield Bond ETF (JNK); Benchmark: Bloomberg Barclays High Yield Very Liquid index, Fund's prospectus may be obtained by calling 1-866-787-2257 or by visiting www.spdrs.com

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