

GOING VIRAL

Kevin Flanagan — Head of Fixed Income Strategy

02/04/2020

This year has gotten off to an unusual start in the financial markets. Typically, the focus would be on the [Federal Reserve \(Fed\)](#) and/or economic developments, but unfortunately the coronavirus has taken center stage. I thought it would be useful to offer some insights from a bond market perspective, using the SARS outbreak of November 2002 to July 2003 as a comparative event.

I'm certainly not the only one doing such an analysis, but what I found is that the SARS episode did not occur in a vacuum. The current coronavirus and attendant risk-off trade is, without a doubt, the key driver of recent developments in the fixed income arena, especially for [Treasuries \(UST\)](#). However, after digging deeper (and being active in the markets at the time), the SARS episode was not necessarily the primary force driving rate trends 17 years ago. At that time, investors were still coping with the aftermath of the 9/11 attacks and anthrax scares of late 2001, as well as the corporate governance scandal (remember Enron and WorldCom). From a macro perspective, the U.S. was just coming out of the 2001 recession and the Fed was in the middle of an aggressive [rate cutting](#) cycle, taking [Fed Funds](#) from 6.50% ultimately down to 1.00% by June 2003.

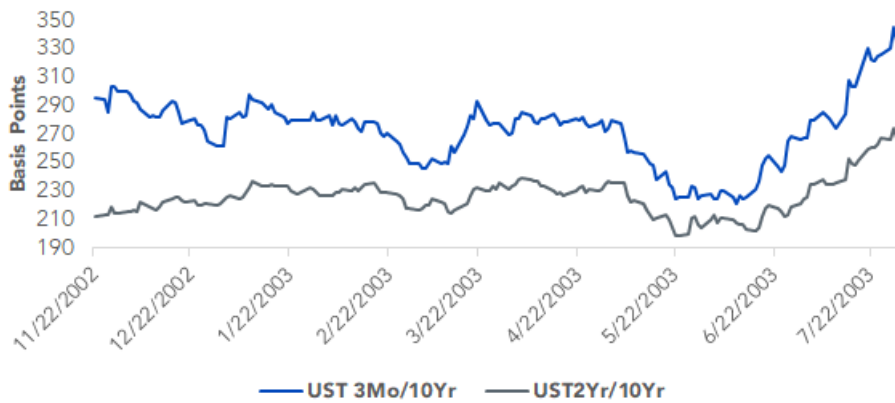
Here are some key highlights and graphs from the Nov. 2002 thru Jul. 2003 period:

- The [UST 10-year yield](#) fell at one point by roughly 105 [basis points \(bps\)](#), but ended up being almost 25 bps higher than the yield level that was posted before the SARS news "hit the tape"
- The 3-month/10-year yield curve flattened at one point by roughly 75 bps, but finished 50 bps wider than the Nov. '02 reading
- The UST 2-year/10-year spread only narrowed by a little less than 15 bps, but was 55 bps wider come the end of Jul. '03
- U.S. real GDP fell to a low of +0.6% in Q4 2002 but snapped back to +7.0% in Q3 2003
- U.S. investment grade and high yield spreads were on a descending trajectory throughout, narrowing by 84 bps and 365 bps, respectively

U.S. Treasury 10-Year Yield



Treasury Curve Yields



Source: Bloomberg, as of 1/30/2020. Past performance is not indicative of future results.

Here are some key highlights for the current period:

- The UST 10-year yield has fallen about 30 bps since the coronavirus headlines began
- The UST 3-mo./10-yr curve has narrowed by a similar 30 bps, reflecting the aforementioned drop in the 10-year yield, and is now inverted again at -2 bps
- The UST 2-yr/10-yr curve has flattened 6 bps to +19 bps
- IG spreads have increased a modest 5 bps while HY spreads have widened more than 65 bps

Conclusion

To be sure, China’s economy is far more of a global influence in 2020 than it was 17 years ago. There is no doubt this outbreak will negatively impact Chinese GDP and, by extension, global growth. Estimates seem to be centered around a drag of around 0.5–1.0 pp for China, and 0.2–0.3 pp for the global outlook, assuming a peak is reached in Q1. While the U.S. is not insulated, the impact on real GDP is only expected to be a couple of percentage points at this time. Indeed, U.S. total trade with China as a percent of GDP is in the low single digits.

Once the coronavirus does peak, we would anticipate history repeating itself in the UST market with the 10-year yield moving back closer to 2% and the aforementioned yield curves re-steepening, and in the case of the 3-mo/10-yr curve, going back into positive territory. HY spreads could also experience some narrowing from the levels as of this writing.

Any economic drags now will more than likely be reversed, and then some, in subsequent quarters. In terms of the Fed, the January FOMC meeting underscored policy being in a holding pattern, despite Fed Funds Futures pricing in two rate cuts this year.

Unless otherwise stated, data source is Bloomberg, as of 1/30/2020.

For more investing insights, check out our [Economic & Market Outlook](#)

View the online version of this article [here](#).

IMPORTANT INFORMATION

U.S. investors only: Click [here](#) to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Kara Marciscano, Jianing Wu and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

DEFINITIONS

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Treasury : Debt obligation issued by the U.S. government with payments of principal and interest backed by the full faith and credit of the U.S. government.

Rate Cut : A decision by a central bank to reduce its main interest rate, usually to influence rates charged by other financial institution.

Fed Fund Futures : A financial instrument that let's market participants determine the future value of the Federal Funds Rate.

10- Year Treasury : a debt obligation of the U.S. government with an original maturity of ten years.

Basis point : 1/100th of 1 percent.