

Daiwa's View

Things to watch for in 2020: Part 1

- Whether market sentiment will again be driven by fear

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Daiwa Securities Co. Ltd.

Whether market sentiment will again be driven by fear

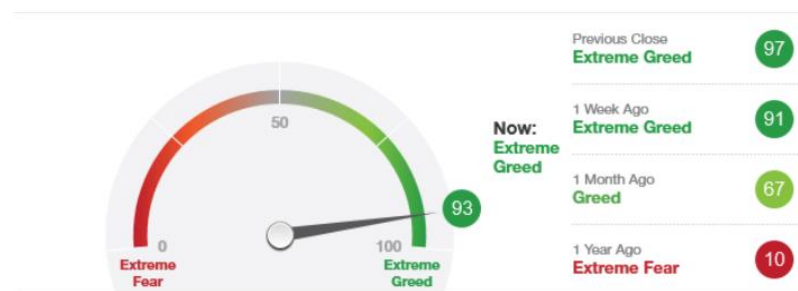
Things to watch for in 2020: Part 1

The year of 2019 closed in an optimistic tone, but the situation made an about-turn and 2020 began with risk-off mode. The 10-year US Treasury yield declined from 1.91% to the 1.78% level, NY WTI crude oil futures rose to \$63, the highest since May 2019, and the yen strengthened by around Y1.5-2 against the dollar from around Y109.6/\$ after the Christmas holidays to Y107.86/\$ (as of 5:00 a.m. on 6 Jan).

There are multiple causes behind this mode. One is the undershoot of the December US ISM manufacturing index vs. the market estimate (actual: 47.2, estimate: 49.0, Nov: 48.1). Other reason would be escalated tension in the Middle East. Due to the weakness in related indicators, US manufacturing activities were expected to contract to some extent, but the reading was even lower. Regarding the situation in the Middle East, Iran has threatened the US with retaliation against General Qasem Soleimani's assassination on 3 January. Caution is thus needed regarding further escalation.

As it is difficult to predict geopolitical tension, there is a risk that the stance on economic activities could become cautious again. However, what we should note at the beginning of the year is that the market in late 2019 might have been driven by unsustainable "extreme greed." This is, in part, witnessed by the "Fear & Greed Index" announced by CNN of the US. Based on seven indicators, investor emotions of fear and greed are indexed from 0-100. The smaller the index, the more investor sentiment is dominated by fear, and the bigger the index, the more investor sentiment is dominated by greed.

Chart: Fear & Greed Index



Last updated Jan 3 at 4:59pm

Source: Extracted from CNN website.

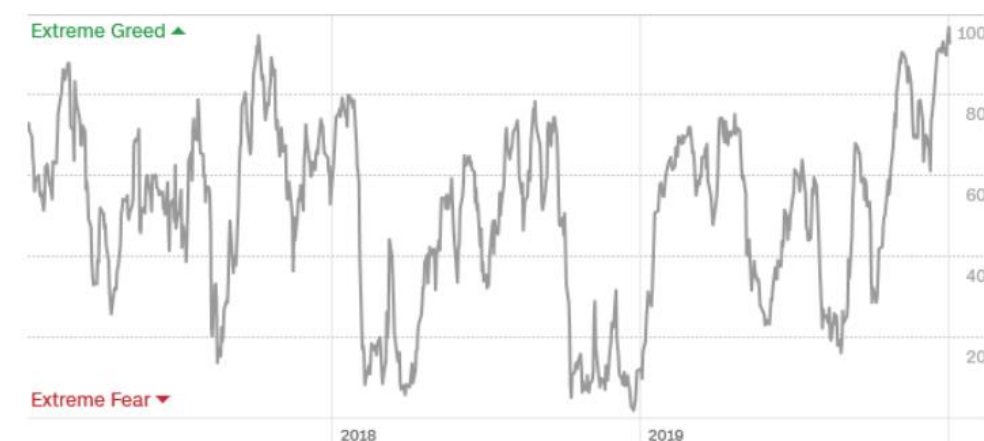
Chart: Component Factors of Fear & Greed Index

	Component factors	Condition	Previous condition	Condition changed on
1	Stock Price Strength	Extreme Greed	Greed	13-Dec-19
2	Junk Bond Demand	Extreme Greed	Greed	05-Dec-19
3	Put and Call Options	Extreme Greed	Greed	13-Dec-19
4	Stock Price Breadth	Extreme Greed	Greed	12-Dec-19
5	Market Momentum	Extreme Greed	Greed	03-Dec-19
6	Safe Heaven Demand	Greed	Extreme Greed	02-Jan-20
7	Market Volatility	Neutral	Fear	15-Aug-19

Source: CNN; compiled by Daiwa Securities.

A year ago, the Fear & Greed Index was just 10, meaning that investors were driven by extreme fear. The index has risen remarkably since September 2019, and reached 97, the highest over the past several years, on 2 January 2020. This implied a possibility that market sentiment around the turn of the year should be described as euphoria, given the continue rise in P/Es for stocks and high-yield CDS spread, which is at the lowest level since the Lehman shock.

If we assume that the index accurately reflects market sentiment, we can say that (1) sentiment of investors (as aggregate) turned 180 degrees from fear to greed throughout 2019 and (2) there is little room to improve sentiment in 2020.

Chart: Fear & Greed Index


Source: Extracted from CNN website.

Of course, there are enough reasons to take an aggressive stance toward risk assets in the current situation where a rise in yields would be less likely given the Fed's high hurdles for rate hikes. The optimism is being boosted also by expectations for fiscal spending and the global manufacturing index, which appears to have finally bottomed out.

However, market sentiment changes often, as shown by the past trends of the Fear & Greed Index¹. In that respect, if we can point out the unwinding of extreme greed (credulousness, optimism) in market activities at the beginning of the year, the important point to watch in 2020 that started with the extreme optimism is whether market sentiment will again be driven by fear.

¹ On average, sentiment sharply declines about twice a year.

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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

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The name of the Credit Rating Agencies group: Moody's Investors Service ("MIS")

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- 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), Nippon Healthcare Investment Corporation (3308), Japan Rental Housing Investments (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%.
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- 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.

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