

MFS INSIGHTS: IT'S HARD TO CONJURE ANIMAL SPIRITS FROM A WOUNDED ANIMAL

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After leaving the US Federal Reserve, former Chairman Ben Bernanke described his mindset during the global financial Crisis in terms of outside-the-box results: “We knew we had to step away from orthodox policies and bring new solutions to the table.”

During the past weeks, global central bankers and fiscal policy makers have been engaged in an existential battle against market dysfunction. At first, these actions aimed to reactivate GFC-era vehicles in order to re-liquefy risk markets while also providing financial support to businesses, local governments and households in need. Having depleted the old playbook amid an increasingly severe crisis, global policymakers devised bold new programs to defend against spreading economic dislocation.

You can find this long and ever-growing list of old and new global stimulus programs and policies in numerous places. Their net result is that the amount of capital being thrown at the global financial system is massive and without precedent. For example, the amount of Fed asset purchases on any single day this week surpasses the amount the central bank bought in any month in 2008. And remember the massive 2009 fiscal package? Well, double it and then some and you'll approximate the size of the fiscal floodtide it is hoped will lift the US economy. Other countries are going big as well. It's a global stimulus-palooza!

It's big. But will it work?

Like in past crises, policymakers first looked to solve liquidity problems in critical markets, such as the money and commercial paper markets. Lack of liquidity, they reasoned, can't be allowed to prevent broad credit markets from functioning. Although progress has been limited thus far, there's clear evidence of waning stress across most credit markets.

In past recessions or periods of crisis, policymakers looked to encourage “animal spirits” via fiscal stimulus. But the genesis of this downturn and the abrupt end of economic activity has been caused by society's attempt to mitigate a health crisis, so the challenges we face are different from those of the past. Indeed, central bankers and policymakers can't incentivize the producer to produce more or the consumer to consume more since what society needs is isolation. Instead, policymakers are trying to aid multiple segments of the economy that are suffering a loss of income. In other words, the traditional stimulus of the past, igniting animal spirits, is at odds with social distancing.

In our view, policymakers may solve a liquidity crisis, and they might. However, we anticipate market bifurcation to grow between the “haves” and the “have nots.” The haves, we believe, are companies that’ve shown that their economic models are defensible. They may be rewarded with above-market-average multiples and below-average debt funding costs. Conversely, we feel the have nots will de-rate and face a higher cost of capital. Innovative though some of these stimulus programs may be, they can’t rejuvenate the spirit of a wounded animal. We believe the economy will need to see the other side of the virus before true animal spirits can return. In the meantime, security selection will probably matter more than ever — or at least more than at any time during our long (and feeling longer all the time) careers.

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