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Finance Department
Treasury Division

DATE: Tuesday, March 10, 2020

TO: Tammy Queen, Director of Finance

FROM: Marcus Whitworth, Manager of Investments MW

RE: Market Reactions - COVID-19 and Crude Oil Shock

The longest economic boom in history, an almost 11-year expansion, appeared to be in its waning stages in the second half of 2019. The Federal Open Market Committee (FOMC) decreased the Federal Funds rate by 25 basis points at three different scheduled meetings, to end the year at 1.75% from 2.50%. After the January 2020 meeting, at which the Committee left the benchmark rate unchanged, Federal Reserve Chairman Jerome Powell described the economy as "moderate" while remaining confident that the current policy was "appropriate" for now.

In recent months the worldwide outbreak of the coronavirus, also known as COVID-19, has wreaked havoc on world markets. The COVID-19 virus, which originated in mainland China, has spread worldwide as the global death toll exceeds 4,000 and there are more than 115,000 cases worldwide. On a positive note, to date, there are over 64,000 individuals that have recovered from the virus.

The World Health Organization said the threat of a pandemic is "very real". Chinese officials state that the number of virus-related cases is declining in China while in other parts of Asia, the Middle East, Europe, and now the US are all witnessing increases in COVID-19 cases. Travel and tourism have come to an abrupt halt. Public events are being canceled from sporting events and festivals to religious ceremonies. Over the weekend, the Italian government introduced drastic quarantine measures restricting the movement of nearly 16 million people in northern Italy. France is considering drastic quarantine measures as well. Ireland cancelled one of its largest St. Patrick's Day parades, Saudi Arabia, the United Arab Emirates, and Kuwait have all cancelled schools for the immediate future. Closer to home, Princeton University is shifting all classes to virtual instruction to finish out the semester. South by Southwest, a huge arts festival in Austin, TX, has been cancelled. Numerous companies are asking their employees to work from home. The game shows Jeopardy and Wheel of Fortune, which typically have older audiences, are now taping without live audiences. The list goes on and on. Locally, over the weekend, there was one confirmed case in each Johnson County and Wyandotte County, Kansas, as well as the first case in Missouri, in St. Louis County.

The FOMC cut the benchmark interest rate, due to COVID-19 fears, by 50 basis points to 1.25% on March 3rd, the first intermeeting move by the FOMC in over a decade. The FOMC's next regularly scheduled meeting is March 18th, at which the market, as of now, is expecting another 50 to 75 basis point cut.

Another separate issue that is causing volatility in world markets has to do with the agreement between OPEC, the Organization of Petroleum Exporting Countries and Russia. This agreement, which has underpinned oil production since 2016, collapsed on Friday after Russian oil minister Alexander Novak, rejected an ultimatum at a Vienna summit to join in a collective production cut due to the coronavirus. Russia has sought to increase production to punish American shale drillers. Saudi Arabia's state energy company, Saudi Aramco, responded by offering unprecedented discounts on Saturday to customers in Asia, Europe, and the United States, when the current OPEC arrangement ends next month. US Crude Oil has declined 50% since the beginning of the year, and over a $10 drop in oil prices on Monday to settle at $31.13 per barrel.

Amid this backdrop of world events, the yield on 10-year US Treasury Notes, a common yardstick to measure the health of the overall economy, has decreased from 1.92% at the end of 2019 to yesterday's close of 0.54%. Yesterday was the first time in history that the entire yield curve, one-month US Treasury Bills out to 30-year US Treasury Bonds have yielded below 1% as investors run to these safe haven assets.

This is said not to frighten, but to reassure, that the investment portfolio of the City of Kansas City, Missouri, is in a good position to weather the storm. In uncertain times, liquidity is particularly important. There are currently higher than normal cash balances within the bank accounts. For the foreseeable future, I am concentrating on building a 1- to 12-week ladder in the amount of $10 million rolling off each week to combat both future virus-related lost revenue and extra expenses. If there are further liquidity needs or the outlook deteriorates materially, a security could be sold to provide additional liquidity. On the earnings front, the City will record approximately $24.9 million in interest income in fiscal year 2020. Additionally, the investments currently in the portfolio are projected to produce interest earnings of $21, $16, $12, and $6 million for fiscal years 21, 22, 23, and 24, respectively.

In closing, there is uncertainty in the marketplace right now. The market does not like uncertainty as uncertainty causes volatility. Will the volatility last a few more days or a couple of years? No one knows. However, based on the preceding paragraph, the City's investment portfolio is in a good position to endure the storm for the next several years.

If there are any questions, please email me at marcus.whitworth@kcmo.org or call me at 513-1023.