



Investment Implications of Elevated Liquidity in the U.S. Financial System

July 5th , 2021

[PG. 2: Analyst Insight](#)

[PG. 3: Local Equities Market](#)

[PG. 4: International Developments](#)

[PG. 5: Local Economic Conditions](#)

[PG. 6: Unit Trust](#)

[PG. 7: Investment Playbook](#)

ANALYST INSIGHT

Awah Muirhead
Senior Investment Strategy Analyst

Investment Implications of Elevated Liquidity in the U.S. Financial System

Background – Basel III Framework

One of the less obvious facts about the Basel III regulatory framework is that it limits the amount of deposits banks can hold on their balance sheets. To clarify, deposits are invariably debt from the perspective of banks and a massive increase, though beneficial from a liquidity perspective, increases a bank's leverage (indebtedness). If we consider the massive amount of stimulus that's been provided to the US market since the start of the pandemic, it can then be understood that U.S. banks have seen a considerable increase in deposits. So, how do the banks remain within the regulatory requirements set out by Basel III when savings and deposits have increased significantly? The answer is to move these deposits or, as strange as it might seem, discourage depositors from depositing. To the latter point, despite rates being at all-time lows, bank deposits remain heightened, again reflecting just how much cash has entered the economy. In this article, we look at how the Fed has been somewhat indirectly managing the excess liquidity it has created through Quantitative Easing (QE) and consider the next move for banks.

The U.S. Department of Treasury ("The U.S. Treasury")

To set further context, we must remember that at the heights of the pandemic, the US Treasury borrowed significant sums at super low rates to facilitate the government's large stimulus packages provided to Americans. Now, the U.S.' debt ceiling or debt limit will come into effect at the end of July. This debt ceiling is a legislative limit on the amount of national debt that can be incurred by the U.S. Treasury, thus limiting how much money the federal government may borrow. Importantly, despite the significant amounts borrowed for pandemic relief, the Treasury did not spend all this cash. Consequently, with the imminent deadline, the Treasury needs to reduce its massive cash balance (approximately US\$ 746 billion as at June 30, 2021) to US\$450 billion by July 31, 2021. As a result, more cash will flow into the financial system that is already highly flushed with cash given the QE actions that have been taken by the Federal Reserve. Again, banks receiving these massive deposits have to offload this excess leverage somehow; therein lies the role of the Federal Reserve's Overnight (O/N) Reverse Repo Program (RRP).

The Rotation into Reverse Repos

Now, given these developments, the Fed raised its O/N RRP rate to 0.05%, making it highly attractive relative to Treasury Bills (T-bills). Specifically, with excess cash in the system, money market rates have been ranging at their lowest levels in recent history. Given this fact, banks and other "Money Market Funds" are earning practically 0% on overnight rates from instruments such as T-Bills. In fact, 6 months T-Bills current yield 0.05%, the same as an O/N RRP, making the Fed's O/N RRP, as stated before, extremely attractive. This characterizes the increased importance and use of the O/N RRP in the last month. In our view, this has been the Federal Reserve's way of managing excess liquidity in the market, without explicitly decreasing bond purchasing or 'tapering'. Further to this point, on June 24, 2021, the Federal Reserve Board indicated that the results of its annual bank stress tests were favorable. Specifically, the Fed noted that "large banks continue to have strong capital levels and could continue lending to households and businesses during a severe recession". Therefore, banks can restart their share buyback activities and pay larger dividends starting June 30, 2021, once they pass this year's stress test; which they have already done. This not only increases returns to shareholders but can reduce the size of the banks (from cash reduction), magnifies their "leverage", and induces even further usage of the RRP.

The Net Effect and Positioning

The net effect of the Fed's actions, is an attempt to reduce liquidity in the market, taking out as much as US\$ 991 billion in a single day via RRP while buying assets of only \$120 billion monthly. This has ultimately maintained stability in what could have otherwise been a somewhat chaotic market, as money market rates would potentially go into negative territory. As banks maneuver these circumstances, we believe the next step for most large banks is to use this opportunity to repurchase shares and make larger dividend payments as they now have the regulatory approval and capital to do so. Consequently, from a positioning perspective, large banks have become even more attractive for investors. Therefore, it may be an opportune time for investors to seek further exposure to this asset class, which doesn't have much correlation to the movements of our local market.

LOCAL EQUITIES MARKET

For the week ended Friday, our local stock market decreased week-over-week. The JSE Combined Index decreased by 1.33%, the Main Market Index decreased by 1.61%, the JSE All Jamaican Composite Index fell by 1.62%, the JSE Junior Market Index improved by 1.92%, and the JSE USD Equities Index remained unchanged.

During the week, JMMB Group 7.25% VR JMD CR Preference Shares was the largest gainer, rising by 36.36% to close at J\$1.50. The biggest loser was MPC Caribbean Clean Energy Limited which fell by 21.21% to close at J\$117.00.

Year to Date, The Junior Market Index (+28.71% YTD) continues to outpace its Main Market counterpart (+7.22% YTD).

As of Friday July 2nd, 2021, overall Market activity resulted from trading in 106 stocks of which 47 advanced, 51 declined and 8 traded firm.. Market volume amounted to 96,773,943 units valued at over \$681,322,155.20. Future Energy Source Company Ltd Ordinary Shares was the volume leader with 15,937,170 units (16.47%) followed by Wigton Windfarm Limited Ordinary Shares with 15,354,470 units (15.87%) and Derrimon Trading Company Limited with 10,848,230 units (11.21%) .

Revisiting relevant news during the week:

Jamaica is among 130 countries and jurisdictions that have joined a new two-pillar plan to reform international taxation rules and ensure that multinational enterprises pay a fair share of tax wherever they operate.

https://www.jamaicaobserver.com/sunday-finance/jamaica-agrees-to-global-minimum-tax-on-large-corporations_225161?profile=1008

PanJam spends more on delayed ROK Hotel, APO, stock split on hold. The 168-room ROK Hotel property won't be completed until November this year. The delay have forced PanJam Investment Limited to pump more cash into the development than initially budgeted. But Chairman Stephen Facey maintains that the adjustment is nominal.

https://www.jamaicaobserver.com/sunday-finance/panjam-spends-more-on-delayed-rok-hotel-apo-stock-split-on-hold_225160?profile=1008

Jamaica has signed off on important grant funding arrangements, paving the way for its long-awaited catastrophe bond issuance to get on the way.

Jamaica has been planning a catastrophe bond issuance for two years now to enhance its disaster insurance arrangements in advance of the 2020 hurricane season. However, the catastrophe bond deal, which had been a work in progress for some years prior, was forcibly delayed by the novel coronavirus pandemic but is now being given full attention.

https://www.jamaicaobserver.com/sunday-finance/jamaica-signs-off-on-catastrophe-bond-grant-agreements_225154?profile=1056

The Statistical Institute of Jamaica (Statin) has reported a 6.7 per cent decline in the economy for January to March or during the first quarter of this year when compared to the same period in 2020.

https://www.jamaicaobserver.com/business-report-daily-biz/statin-reports-6-7-per-cent-decline-in-economy-jan-march_225006?profile=1056

Index	02/07/2021	25/6/2021	31/12/2020	Week/Week	Year-to-Date
JSE Main Market	424,163.22	431,109.83	395,614.93	-1.61%	7.22%
JSE Junior Market	3,402.30	3,338.17	2,643.38	1.92%	28.71%
JSE Combined Market	426,876.85	432,634.29	392,435.92	-1.33%	8.78%
JSE USD Equities Market	195.46	195.46	186.30	0.00%	4.92%
JSE All Jamaican Composite Index	463,917.06	473,387.69	433,521.09	-1.62%	7.01%

INTERNATIONAL DEVELOPMENTS



The S&P 500 Index and Nasdaq Composite Index moved to new highs and closed out a fifth consecutive quarterly advance. Large-cap growth stocks led the gains, with the Russell 1000 Growth Index stretching its weekly winning streak to eight. Technology and health care stocks led the gains within the S&P 500, and consumer discretionary stocks were also strong, boosted by a solid rise in Nike shares. Small- and mid-caps underperformed after strong gains the previous week. T. Rowe Price traders noted that quarter-end rebalancing caused some increase in volumes, but they remained relatively muted. U.S. markets were set to be closed on Monday, July 4 in observance of the Independence Day holiday.

Generally favorable economic data seemed to support sentiment. The Conference Board's index of consumer confidence beat expectations and reached a 16-month high. The spirits of homeowners—if not buyers—may have been lifted by gains in housing prices, which also surprised on the upside. The strong labor market was another factor in making Americans feel more optimistic about their economic prospects. On Friday, the Labor Department reported that employers had added 850,000 nonfarm jobs in June, well above consensus estimates of around 700,000 and the most since last August. Weekly jobless claims also fell more than expected, to a pandemic-era low of 364,000.

The Institute for Supply Management's (ISM's) gauge of factory activity fell a bit more than expected but still indicated healthy expansion. ISM researchers cited labor and material shortages as preventing even faster growth. Pending home sales data may have been the biggest surprise of the week, jumping 8% in May in contrast to consensus expectations for a slight decrease.

<https://www.troweprice.com/personal-investing/resources/insights/global-markets-weekly-update.html#US>

Top Things to Watch in Markets in the Week Ahead

- 1. Fed Minutes:** The minutes of the Fed's June meeting, when officials opened talks on tapering bond-buying and indicated interest rate increases could come sooner than previously anticipated, are due to be released on Wednesday
- 2. ISM Services Data:** The ISM index of service industry activity is set to be released on Tuesday and is expected to show continued strong growth after hitting a record high in May amid a reopening made possible by vaccinations against the coronavirus. The report could also underline ongoing labor constraints as hiring continues to lag, leading companies to offer higher wages to attract staff.
- 3. Second Half:** With markets into the second half of 2021, investors are now wondering if the stunning first half run can continue. Though U.S. stock markets are holding near record highs, some market analysts have pointed to signs of caution in some areas of the market.
- 4. ECB Minutes:** The ECB is to publish the minutes of its June policy meeting on Thursday. ECB-watchers will also be on alert for news of several meetings due to take place in the coming weeks as part of the banks review of its monetary policy strategy.
- 5. China Inflation:** China is to release data on both consumer price inflation and producer price inflation on Friday. Market watchers will be paying close attention to the cost of raw materials, which have soared due to higher commodity prices, and whether these increases are being passed onto the consumer.

<https://www.investing.com/news/economy/top-5-things-to-watch-in-markets-in-the-week-ahead-2543304>

Index	02/7/2021	25/6/2021	31/12/2020	Week/Week	Year-to-Date
Dow Jones	34,786.35	34,433.84	30,606.48	1.02%	13.66%
S&P 500	4,352.34	4,280.70	3,756.07	1.67%	15.87%
NASDAQ 100	14,727.63	14,345.18	12,888.28	2.67%	14.27%
FTSE 100	7,123.27	7,136.07	6,460.52	-0.18%	10.26%
Euro Stoxx 50	4,084.31	4,120.66	3,552.64	-0.88%	14.97%

Local Economic Conditions

Local Foreign Exchange Market

- Our local currency depreciated marginally by 0.49% against the U.S. Dollar week on week to settle at \$151.28 as at close of trade Friday, relative to \$150.55 per US\$1.00 at the end of the prior week. Year to date, the Jamaican dollar has depreciated by approximately 6.05%.

Interest Rates and Inflation

- The BOJ continues to maintain an accommodative monetary policy since gaining its independence to support the current environment. As at their latest policy decision announcement, they maintained rates a 0.50%
- At this rate, based on its assessment, the BOJ notes that inflation will generally continue to remain within the target of 4.0% to 6.0% over the next two years.
- As at May 2021, point-to-point was recorded at 5.0%.
- Barita's Collective Investment Schemes ("CIS") offer the opportunity for investors to remain invested in the market at this delicate stage of the market cycle; moreover, there is a diversification benefit and opportunity to have a professional portfolio manager make the best-in-class professional judgements on your behalf.
- The F.X. Growth Fund, which is benchmarked against the S&P 500, has increased by 3.95% year to date.
- As at July 2nd, 2021, the Capital Growth Fund has delivered a YTD return of 9.97%, which surpasses its benchmark of the JSE Combined Index
- The FX Bond Portfolio remains an attractive fixed-income portfolio, particularly when viewed within the context of global interest rates which have declined significantly as central banks maintain low policy rates to drive the economic recovery.

Currency Pair	2/7/21	25/6/21	31/12/20	W-o-W	Year-to-Date
JMD: USD	150.45	151.28	142.65	0.54%	5.46%
JMD:CAD	122.65	123.48	111.41	0.67%	-10.09%
JMD:GBP	209.23	210.05	193.66	0.39%	-8.04%

Unit Trust Performance

- Year to Date, The Money Market Fund has increased by 1.67%, the FX Bond Portfolio has increased by 0.71%, the F.X. Growth Portfolio increased by 3.95%, the Real Estate Portfolio has decreased by 2.81% and the Capital Growth Fund has grown by 9.97%.

"It's not how much money you make, but how much money you keep, how hard it works for you, and how many generations you keep it for."

— Robert Kiyosaki

Unit Trust

Unit Trust Fund	30/6/2021	25/6/2021	Week/Week Return	Year-to-Date Return	1 Year Return	Yield
Capital Growth	93.33	93.90	-0.61%	9.97%	16.51%	-
Money Market	15.0226	15.0592	-0.24%	1.67%	3.41%	1.81%
Income Portfolio	100.00	100.00	-	-	-	2.23%
FX Bond Portfolio (US\$)	1.3659	1.3676	-0.12%	0.71%	5.54%	1.97%
Real Estate Portfolio	5,670.91	5,716.61	-0.80%	-2.81%	-14.07%	-
FX Growth Portfolio	1.0380	1.0265	1.12%	3.95%	16.75%	-

If you're a millionaire by the time you're 30 but blow it all by age 40, you've gained nothing. Grow and protect your investment portfolio by carefully diversifying it, and you may find yourself funding many generations to come.

- Robert Kiyosaki

Investment Playbook



Equities

Stock Ticket	Stock Information (As at July 2 nd , 2021)	Analyst Outlook
WISYNCO Wisynco Group Ltd	P/E: 22.17	OVERWEIGHT The local fiscal support to both households and businesses was instrumental in maintaining individuals' consumption capacity, particularly those furloughed and made redundant, which supported the demand for consumer staples distributed by manufacturers and distributors Wisynco. We expect that with continued fiscal support through either direct household support or government spend on projects to stimulate employment, Wisynco's business will thrive in this environment.
	P/B: 3.97x	
	Price: J\$15.96	
	Div Yield: 1.19%	
LASM Lasco Manufacturing	P/E: 16.32x	OVERWEIGHT The local fiscal support to both households and businesses was instrumental in maintaining individuals' consumption capacity, particularly those furloughed and made redundant, which supported the demand for consumer staples distributed by manufacturers and distributors LASM. We expect that with continued fiscal support through either direct household support or government spend on projects to stimulate employment, LASM's business will thrive in this environment. Given that more restrictive curtailment measures do not seem likely, LASM is likely to perform better than in the April - June quarter. The national curfew measures were particularly restrictive and, therefore, negatively impacted LASM's revenue growth.
	P/B: 2.86x	
	Price: J\$5.45	
	Div Yield: 1.11%	
LASD Lasco Distributors	P/E: 16.44x	OVERWEIGHT The local fiscal support to both households and businesses was instrumental in maintaining individuals' consumption capacity, particularly those who were furloughed and made redundant, which supported the demand for consumer staples distributed by manufacturers and distributors as LASD. We expect that with continued fiscal support through either direct household support or government spend on projects to stimulate employment, LASD's business will thrive in this environment.
	P/B: 1.90x	
	Price: J\$4.26	
	Div Yield: 1.20%	

Ratings Definitions

OVERWEIGHT/BUY

Exposure to this asset should be between 5% and 10% of your total portfolio

MARKETWEIGHT/HOLD

Exposure to the asset should be equal to 5% of your total portfolio

UNDERWEIGHT

Reduce exposure in your portfolio to less than 5% for this particular asset

SELL

Reduce exposure in your portfolio to zero

Investment Playbook



Equities

Stock Ticker	Stock Information (As at July 2 nd , 2021)	Analyst Outlook
SEP Seprod Limited	P/E: 18.03x	OVERWEIGHT Seprod has undergone significant structural changes within the last 5-years aimed at improving the underlying performance of the company. Within this period, particular emphasis has been placed on optimizing the distribution, warehousing and logistics capabilities of the company. This gradual, multi-year, improvement was accomplished through reinvestment within the organization coupled with strategic acquisitions aimed at increasing the distribution reach and quality of the company. Another major change was the closure of the Group's loss-making sugar division; a move that enhanced shareholder value. These changes have positioned Seprod to deliver robust growth through an expansive product mix and access to consumer markets both locally and regionally.
	P/B: 3.07x	
	Price: J\$70.69	
	Div Yield: 0.85%	
PROVENJMD Proven Investments Limited	P/E: 17.95x	OVERWEIGHT Given the current economic environment, characterized by low interest rates and increased uncertainty, PIL has shifted from the carry trade business to more private equity and real estate ventures, thereby allowing for diversification benefits to be realized - particularly as it relates to the "spreading" of risk. Given the business model of PIL wherein capital is used to acquire strategic assets, this APO is expected and should make the stock accessible to a wider pool of investors. At present, only a small subset of listed companies pursue private equity investments which makes PIL an attractive security for investors who want the liquidity the stock market provides as well as exposure to non-listed companies that can provide value.
	P/B: 1.15x	
	Price: \$35.92	
	Div Yield: 2.19%	

Ratings Definitions

OVERWEIGHT/BUY

Exposure to this asset should be between 5% and 10% of your total portfolio

MARKETWEIGHT/HOLD

Exposure to the asset should be equal to 5% of your total portfolio

UNDERWEIGHT

Reduce exposure in your portfolio to less than 5% for this particular asset

SELL

Reduce exposure in your portfolio to zero

Investment Playbook



Equities

Stock Ticker	Stock Information (As as July 2 nd , 2021)	Analyst Outlook
PROVENUS Proven Investments Limited	P/E: 18.26x	OVERWEIGHT Given the current economic environment, characterized by low interest rates and increased uncertainty, PIL has shifted from the carry trade business to more private equity and real estate ventures, thereby allowing for diversification benefits to be realized - particularly as it relates to the "spreading" of risk. Given the business model of PIL wherein capital is used to acquire strategic assets, this APO is expected and should make the stock accessible to a wider pool of investors. At present, only a small subset of listed companies pursue private equity investments which makes PIL an attractive security for investors who want the liquidity the stock market provides as well as exposure to non-listed companies that can provide value.
	P/B: 1.17x	
	Price: US\$0.25	
	Div Yield: 3.07%	
SCIJMD Sygnus Credit Investments	P/E: 13.32x	OVERWEIGHT Sygnus provides funding to Mid-Size firms within the lending market, which is considered to have a higher risk and generally overlooked by providers of traditional financing forms. This provides a largely untapped/under-tapped niche market within the Caribbean lending space for Sygnus, a few direct competitors. The flexibility in the financing terms offered by the Company is a clear advantage to borrowers, and it allows SCI to manage its credit risk to generate double-digit risk-adjusted returns on investments, which, consequently, bolsters shareholder value.
	P/B: 0.64x	
	Price: J\$15.08	
	Div Yield: 2.38%	
SCIUSD Sygnus Credit Investments	P/E: 19.74x	OVERWEIGHT Sygnus provides funding to Mid-Size firms within the lending market, which is considered to have a higher risk and generally overlooked by providers of traditional financing forms. This provides a largely untapped/under-tapped niche market within the Caribbean lending space for Sygnus, a few direct competitors. The flexibility in the financing terms offered by the Company is a clear advantage to borrowers, and it allows SCI to manage its credit risk to generate double-digit risk-adjusted returns on investments, which, consequently, bolsters shareholder value.
	P/B: 0.95x	
	Price: US\$0.15	
	Div Yield: 1.66%	

Ratings Definitions

OVERWEIGHT/BUY

Exposure to this asset should be between 5% and 10% of your total portfolio

MARKETWEIGHT/HOLD

Exposure to the asset should be equal to 5% of your total portfolio

UNDERWEIGHT

Reduce exposure in your portfolio to less than 5% for this particular asset

SELL

Reduce exposure in your portfolio to zero

Investment Playbook



Equities

Stock Ticker	Stock Information (As at July 2 nd , 2021)	Analyst Outlook
CCC Caribbean Cement Company	P/E: 25.19x	OVERWEIGHT Throughout the COVID-19 pandemic, all industries have been affected by what has been a significant downturn in aggregate demand as the pandemic has created a need for persons to reduce travelling and physical interaction. Despite this setback which predominantly materialized in Q2 of 2020, the construction industry has rebounded significantly (7.0% in Q3 2020 and 6.2% in Q4 2020), ahead of many other industries and well ahead of the overall economy. This strong growth over the last two reported quarters has been a significant tailwind for Caribbean Cement and the company has consequently seen a significant increase in the demand for its product, well in excess of previous years. On the heels of what has been a great year for the company, management expects demand to increase further, fuelled by upcoming government projects that will require substantial cement deposits. The recent government budget lends to this expectation as one of the main components of the government's SERVE Programme is infrastructure development. With that said, the company is positioning itself to meet this demand while maintaining its more efficient cost structure which was displayed in 2020, chief among these was the reduction of debt, which in turn reduced the company's cost of debt.
	P/B: 6.17x	
	Price: J\$94.73	
	Div Yield: 0.00%	
LAB The Limners and Bards Limited	P/E: 19.44x	OVERWEIGHT The LAB provides a unique opportunity for investors to get exposure to the first and only advertising and film production company listed on the Jamaica Stock Exchange (JSE). The Lab's business model is built on providing innovative solutions to clients through its main services including its brand/communication strategy, campaign concepts & execution, media buying, and film production. Throughout the pandemic, the company has repositioned its business to meet the demand of clients who needed digital solutions. Consequently, while many industries and companies faltered in 2020, The Lab reported strong top and bottom-line growth of 44.30% and 34.13%, respectively. This growth has continued into 2021, reflecting significant double-digit growth in two of the company's three operating segments. Against the backdrop of a strong, stable business model coupled with robust financial performance, we have issued an OVERWEIGHT recommendation for The Limners and Bards Limited.
	P/B: 5.79x	
	Price: J\$3.11	
	Div Yield: 2.38%	

Ratings Definitions

OVERWEIGHT/BUY

Exposure to this asset should be between 5% and 10% of your total portfolio

MARKETWEIGHT/HOLD

Exposure to the asset should be equal to 5% of your total portfolio

UNDERWEIGHT

Reduce exposure in your portfolio to less than 5% for this particular asset

SELL

Reduce exposure in your portfolio to zero

Investment Playbook



Equities

Stock Ticker	Stock Information (As at July 2 nd , 2021)	Analyst Outlook
CPFV Eppley Caribbean Property Fund SCC	P/AFFO: 33.86x	OVERWEIGHT Since Eppley became the investment manager of the fund, there has been a material improvement both in portfolio’s country exposure and type of real estate structures. This has led to a steady increase in the total square feet of the portfolio and increase Net Asset Value (NAV) with diversification. The Fund’s pivot towards introducing Jamaican assets, especially in the industrial space will have a positive material impact on the company’s long-term performance. This as the Manufacturing and Distribution (M&D) and construction industry have shown material resilience to the impact of COVID-19. As such, the continued focus on improving value to shareholders through divesting away from Barbados and retail properties will act as a positive tailwind for the long-term performance of CPFV.
	Price: J\$45.00	
	AFFO Yield: 2.95%	
MAILPAC Mailpac Group Limited	P/E: 20.94x	OVERWEIGHT Having raised just under \$500 million in its November 2019 junior market initial public offering (IPO), by March of 2020 the global economy was grappling with the COVID-19 crisis. This posed both a challenge and an opportunity for the Mailpac Group given the sudden and immediate need for e-commerce capabilities in light of social distancing and other non-medical interventions to reduce the spread of the virus. That the company was able to generate \$1.7 billion in revenue during 2020 is demonstrative of the management’s agility and competence of the company’s leadership. They were able to pivot in building both scale and capacity, which are likely to sustain Mailpac’s performance prospectively, given the likely scenario that e-commerce is likely to become more enconsced among Jamaica consumers, across various social classes.
	P/B: 17.95x	
	Price: J\$3.77	
	Div Yield: 3.98%	

Ratings Definitions

OVERWEIGHT/BUY

Exposure to this asset should be between 5% and 10% of your total portfolio

UNDERWEIGHT

Reduce exposure in your portfolio to less than 5% for this particular asset

MARKETWEIGHT/HOLD

Exposure to the asset should be equal to 5% of your total portfolio

SELL

Reduce exposure in your portfolio to zero