WEEKLY UPDATE

CARY STREET PARTNERS

APRIL 27, 2020

EQUITY MARKETS

Equity markets were calmer this week, as the S&P 500 finished the week with a 1.3% decline.[1] Forward volatility continues to remain elevated, as indicated by a CBOE Volatility Index (VIX) finishing in the high 30's.[1] The S&P 500 retraced approximately half of the decline leading up to the March 23rd low, prior to declining slightly this week. The probability of a re-test of that low, or a series of higher lows on pullbacks, remains high, while volatility remains heightened. We increasingly see the latter, a series of higher lows, as the more likely outcome. Progress on the COVID-19 virus remains the most important news driver. Horrific economic and earnings news are more-or-less meeting expectations. COVID-19 progress will allow the markets to look forward, through the bad news to recovery. Keep in mind, markets tend to be three to six months ahead of economic and earnings developments.

DEBT IN THE OIL PATCH — SPOTLIGHT ON THE ENERGY SECTOR

There was a good deal of drama in the oil markets this week. Investors are likely to have seen a lot of media coverage of oil dropping to negative values. This is only a portion of the story. What those reports were referencing was pricing on the May futures contract as it was nearing expiration.[1] Contracts for delivery in future months never went negative.[1] That said, there is a huge problem in the oil patch these days. There is far too much supply as the world is awash in crude as demand has evaporated. This past week supply was reaching the point of saturating storage facilities (hence the futures movement). Companies are now shutting in production, which will alleviate the storage issue. But low oil prices for longer is a very likely scenario. It should also be noted that the oil industry in the U.S. has been a problem child for some time. There has been some eye-watering leverage employed in the industry. The entire U.S. energy sector is now worth approximately half of Microsoft's market value.[1]

Below are observations from one of our industry partners Pimco.

INDUSTRY CHALLENGES

- Within high-yield energy, there has been material stress given oil prices that have been in low to mid $20s per barrel for the past several weeks, trading well below profitable prices.
- The energy sector represents approximately 12% of the high-yield debt market and this sector could easily see 50% default rates.
- The most stressed energy names had traded down with initial volatility in February. This recent downdraft penalized a new group, the mid-tier companies.
- In the last period of price softness (2015-2016) there were a lot of private equity funds specializing in destressed debt lining up to buy energy assets. Recoveries have been weak since then.
- The energy market is bifurcated with companies that are oil-centric (exploration and production, oilfield services) that will struggle without hedges in the current oil price environment, and certain natural gas producers (with enough near-term liquidity) that will benefit from now lower production in natural gas, relieving an oversupply of natural gas.

Source: Pimco

WEEKLY BENCHMARKS

GROUP/INVESTMENT	YTD Return (Cumulative) 4.24.2020
US EQUITY BENCHMARKS	
S&P 500 TR USD	-11.66
DJ US TR USD	-12.58
RUSSELL 1000 TR USD	-12.25
RUSSELL 1000 VALUE TR USD	-21.02
RUSSELL 1000 GROWTH TR USD	-4.00
RUSSELL 2000 TR USD	-25.76
INTERNATIONAL EQUITY BENCHMARKS	
MSCI FV ACWI EX USA NR USD	-20.49
MSCI FV ACWI NR USD	-15.60
US FIXED BENCHMARKS	
BBGBARC US TREASURY BILLS TR USD	0.63
BBGBARC US AGG BOND TR USD	4.99
BBGBARC US CREDIT TR USD	1.20
ICE BOFA US HIGH YIELD TR USD	-10.55
ICE BOFA US MBS TR USD	3.24
INTERNATIONAL FIXED BENCHMARKS	
BBGBARC GLOBAL AGGREGATE TR USD	0.68
US FIXED MUNI BENCHMARKS	
BBGBARC MUNICIPAL TR USD	-1.14
REAL ASSETS	
FTSE NAREIT ALL EQUITY REITS TR USD	-20.34
SPDR® GOLD SHARES	12.53

Source: Bloomberg

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CREDIT MARKETS

Spreads on corporate bonds, a measure of additional risk investors are willing to take to own the debt of corporations as opposed to government, have declined to 200 basis points.[2] The spread rose to 326 basis points in late March, the average for the last decade is 145 basis points.[2]

The Collateral Loan Obligation (CLO) market is approximately $700 billion in size. The CLOs have not recovered from their mid-March low and are typically trading under 70 cents on the dollar.

ECONOMIC NEWS

Fannie Mae and Freddie Mac's regulator reported Wednesday that it will let the mortgage giants buy new loans that have entered forbearance in an effort to ease market disruptions.[3]

Congress has passed and the Administration signed the most recent $484 billion relief bill. These funds will contribute to the Paycheck Protection Program (PPP). In addition, $75 billion goes to hospitals and $25 billion to COVID-19 testing.

March durable goods orders fell 14.4%, more than the consensus drop of 12%. This is the final economic release before Q1 GDP this week.[3]

[1]Bloomberg

[2]Bloomberg Barclays Global Aggregate

[3]Bloomberg

Past performance is no guarantee of future results.