clearstead

RESEARCH CORNER

APRIL 20, 2020

OBSERVATIONS

- Covid-19: Limited clinical evidence suggests that Gilead Sciences' anti-viral drug Remdesivir, developed for treating Ebola, can be effective in treating critically sick Coronavirus patients.
- The Small Business Administration is unable to accept new applications for the Payroll Protection Program (PPP) as the $349 billion first come, first serve program's funds have been exhausted. The White House and Congress are closing in on a deal that would earmark an additional $300 billion to small businesses.
- May oil futures contract trading under $12/bbl (as of this writing), near a 22-year low. As oil storage issues continue, there are an estimated record 160mm barrels of oil being stored at sea (previous record 100mm barrels at sea in 2009).[1]
- The U.S. Conference Board's Leading Economic Indicator (LEI) Index registered its largest ever decline in its 60 years of history in March.
- China's GDP contracted by 6.8%[2] on an annualized basis in Q1-2020 marking the first ever quarterly decline in GDP since China began publishing these statistics in 1992.
- The S&P 500 has now returned over 26% since the March 23 lows - led by big tech. Microsoft, Alphabet, Amazon, Apple, & Facebook (the top 5 companies in the index by weight) now account for a combined 21% of the index. This marks an all-time high for the top 5 and surpasses the 2000 internet bubble peak where the top 5 companies (Microsoft, GE, Cisco, Intel, & Walmart) represented 18% of the S&P 500.[3]

EXPECTATIONS

- Thursday's (4/30) initial jobless claims report (expectations of 4.5mm) will bring the 4-week total of jobless claims to a level that will wipe out all the job gains seen during the prior 11-year business cycle.
- Approximately 86 companies in the S&P 500 have suspended earnings guidance during recent earnings calls suggesting that many companies are struggling to determine the full impact of the Coronavirus on their businesses. With 96 S&P 500 companies expected to report this week, investors are more likely to be focused on corporate liquidity rather than earnings.

OPPORTUNITIES

- Fill up on gas! The National average for regular unleaded gas is $1.82/gallon ($1.42 in Ohio).[4]
- As states look to reopen their economies, investors should consider sectors that could quickly benefit from pent-up demand—construction, remodeling, and select infrastructure, which could also spill over into key transport and freight sectors.

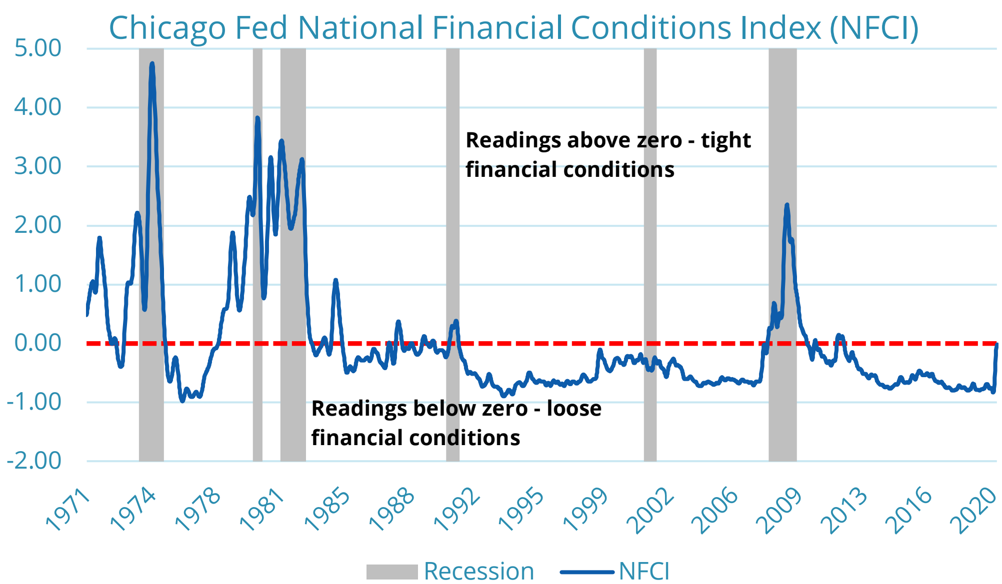
ONE MORE THOUGHT

As the crisis continues to evolve, we have seen deflationary contagion fears grip some market participants like during the 2008-2009 financial crisis. On the point of contagion, particularly in the U.S. banking system, we think it is important to reflect on a few factors that make for a fundamentally different circumstance today vs. '08-'09. First and foremost, U.S. banks have spent a decade increasing capital and liquidity buffers as a result of the financial crisis. Second, stringent ongoing stress testing, liquidity ratio scrutiny, and Basel III standards have ensured banks remedy weaknesses by raising capital – **particularly those institutions deemed systemically important**. Further,

[1] *Reuters*
[2] *Bloomberg LP*
[3] *Marketwatch.com, BofA Global Investment Strategy, Bloomberg LP, as of 4/17/20*
[4] *AAA, as of April 19, 2020*

regulatory initiatives such as Dodd Frank and the Volcker Rule helped limit certain forms of risk taking (e.g. prop trading) by banks. Next, changes made to financial reporting standards (notably FASB 157 – marked to market accounting) during the financial crisis now allows banks to mark illiquid assets to 'model' rather than to 'market'. This, in theory, allows balance sheets to reflect fundamental realities as oppose to prices in dislocated markets thereby reducing the risk of negative cascading effects in the financial system. Lastly, as we have noted in prior, the Federal Reserve has enacted several programs to help lend support to the system's safety and soundness. The result is a U.S. financial system better equipped to manage through this crisis than ever before. These are statements of the financial system in sum – there could be pockets of discomfort within certain banks that were engaged in riskier lending (expect bank M&A, not bank failures). Financial system contagion seems unlikely.

GRAPHIC OF THE DAY



Source: Cleastead, Federal Reserve Bank of Chicago, Chicago Fed National Financial Conditions Index [NFCI], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/NFCI, April 19, 2020.

The Chicago Fed NFCI shows the extent to which financial conditions have tightened during the Covid-19 crisis. This follows a multi-year period of relatively loose (benign) financial conditions. The Fed's numerous measures have clearly helped to mitigate financial conditions from worsening - for now.

Carl Tippit, CFA
Head of Investments
Clearstead

Aneet Deshpande, CFA
Chief Strategist
Clearstead