

**APRIL 27, 2020**
**OBSERVATIONS**

- Covid-19: Global cases exceed 2.99 million (207k deaths), U.S. cases over 965k (over 55k deaths). Five countries have now recorded over 20k deaths per country (U.S., Italy, Spain, France, and U.K.).
- J.D. Power notes that April auto sales have stabilized versus an abysmal March, though still down nearly 50% from pre-crisis forecasts. IHS Markit expects global vehicle demand to decline 22% YoY in 2020.
- Barclays iPath Crude Oil Exchange Traded Note (ETN) becomes first casualty of the collapse in oil's May futures contract. The ETN will liquidate on 4/30.
- Economic activity in the Eurozone hits a new low – Eurozone composite PMI index falls to 13.5 in April, an all-time low for the index since first being published in 1998. The measure troughed at 36.2 in Feb 2009 during the financial crisis. Readings below 50 indicate contraction in manufacturing and services activity<sup>1</sup>.
- Jobless Claims released Thursday (4/23) showed another 4.4 million Americans applied for unemployment benefits. This brings the 5-week total to 26.5 million jobs lost or 16.5% of the labor force.<sup>2</sup>
- 3.4 million borrowers (6.4% of all mortgages outstanding - \$754 billion in unpaid principal) are now in mortgage forbearance plans provided by the CARES Act.<sup>3</sup>
- Saddled with \$4bn in long-term debt, 113-year-old Neiman Marcus is expected to file for bankruptcy (chapter 11 reorganization) within days/weeks. Struggling J.C. Penny is also closing in on Chapter 11 filing.

**EXPECTATIONS**

- The number of bankruptcies in the exploration & production (E&P) sector reached 42 in 2019. Oil at \$20/bbl would likely force another 140 E&P companies into bankruptcy in 2020 with another 393 in 2021. At \$10/bbl, cumulative bankruptcies would exceed 1,100 E&P companies by the end of 2021.<sup>4</sup>
- Netflix added 15.77 million subscribers<sup>5</sup> during the Q1 more than doubling their own forecast. However, majority of subscribers came from overseas and a substantially stronger U.S. dollar offset revenues from subscriber growth. The surge in the U.S. dollar is likely to continue to weigh on corporate profits.
- Some risks to the rally continuing in May are an acceleration of new infections in the first wave of states that reopen, greater difficulty in coming up with effective treatments, and economic data and company earnings announcements could likely be worse than markets expect.
- Busy week ahead: 172 S&P 500 companies are due to report earnings (including Microsoft, Apple, and Amazon), the Federal Reserve meets Tuesday and Wednesday (4/28 & 4/29) – no substantive changes expected, preliminary Q1 GDP Wednesday (4/29), and jobless claims Thursday (4/30).

**ONE MORE THOUGHT**

Last week's volatility in oil futures markets highlighted a key risk within the world of exchange traded funds. These products are commonly bifurcated between Exchange Traded Funds (ETFs) and Exchange Traded Products (ETPs). Within the category of ETPs sits Exchange Traded Notes (ETNs). For investors, the differences between these products matters – most of the time we think of these as low probability, high impact differences. Focusing in on ETFs vs ETNs, while trading characteristics and underlying assets are critical features for all these products, structure is an often-neglected nuance between the two. An ETF holds assets (e.g. stocks, bonds etc.), which serves

<sup>1</sup> IHS Markit

<sup>2</sup> Bloomberg LP

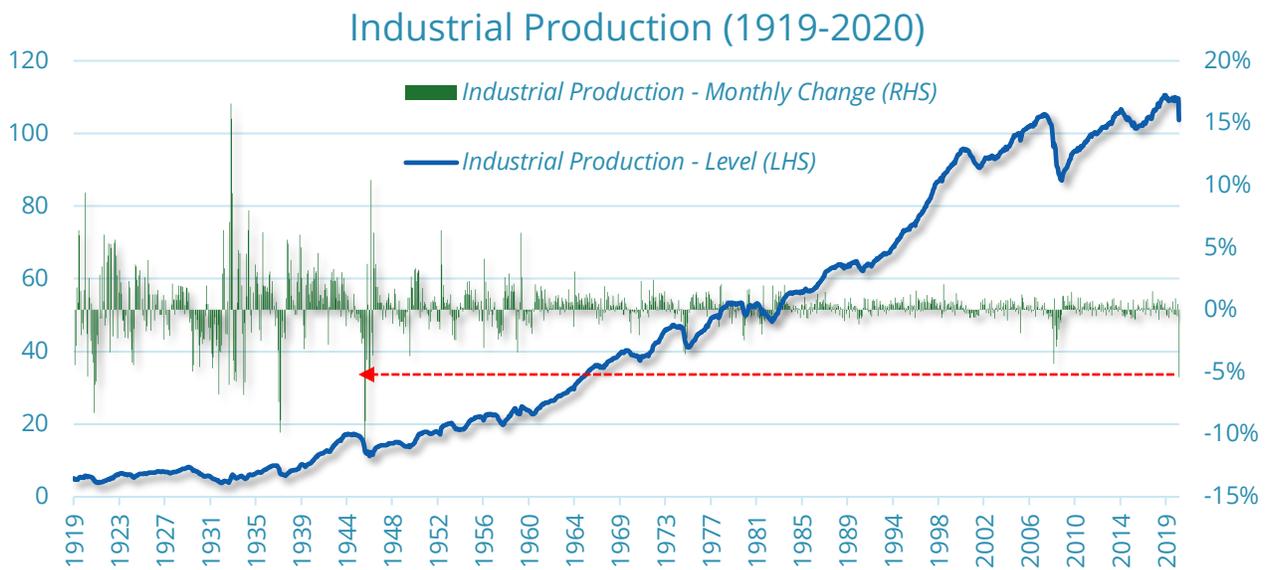
<sup>3</sup> CNBC.com, *Black Night mortgage and data analytics*, April 24, 2020

<sup>4</sup> Rystad Energy, *CNN.com*

<sup>5</sup> Netflix quarterly earnings report, April 21, 2020

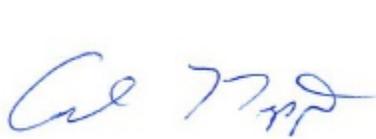
as the basis for the ETF's net asset value and trading price. Contrasted to an ETN which is a senior, unsecured debt issued by an investment bank that matures over time and generally has early redemption features. The ETN is designed to track an index (e.g. oil or volatility) – and unlike an ETF, an ETN does not own the underlying asset. Both products have revolutionized markets and have opened markets historically only available to large institutional investors. While the product structures are different, similarities can exist with how the two get their investment exposure. Both ETFs and ETNs can gain their investment exposure via derivatives markets, like oil futures. This leaves investors exposed to nuanced risks that exist in futures markets (e.g. futures contract roll). The result of these nuances can lead to substantial losses, or an investment experience that largely deviates from the original investment intention. Times like this are a healthy reminder of the importance of understanding what you own.

## CHART OF THE DAY



Source: Clearstead, Board of Governors of the Federal Reserve System (US), Industrial Production Index [INDPRO], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/INDPRO>, April 21, 2020.

The -5.4% monthly decline in March of industrial production was a 75-year record. Important to note that while the monthly decline was extraordinary, the absolute level continues to be well above the levels seen during the '08-'09 recession. Declines likely further ahead, but context is important.



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