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Market Update: 03.09.2020

STOCKPILING ON

Investors needn't another layer of uncertainty, but received one anyway over the weekend after a meeting of members of the Organization of the Petroleum Exporting Countries (OPEC) and its partner countries (together OPEC+) collapsed. Saudi Arabia slashed prices and matched threats from Russia to increase production. Meantime, COVID-19 cases surged in the U.S. and in Europe, with sovereign and local governments implementing increasingly strict measures to contain the spread. With global growth already suffering from coronavirus pressures, contagion took on another meaning as investors began to worry about an oil sector-driven credit crisis. Risk markets tanked around the world as U.S. Treasuries soaked up that anxiety. When we wrote in last month's commentary that we always should be expecting the unexpected, we didn't think we'd find so soon such a stark example.

Fresh Worries

We can start with what's new from the weekend. With oil demand already weaker from the utilization-dampening effects of the virus, the threat of vastly increased production likely will intensify the supply/demand mismatch. Crude oil prices dropped more than 30% after OPEC effectively broke up with its partner Russia.

Figure 1: Oil in U.S. Dollars per Barrel

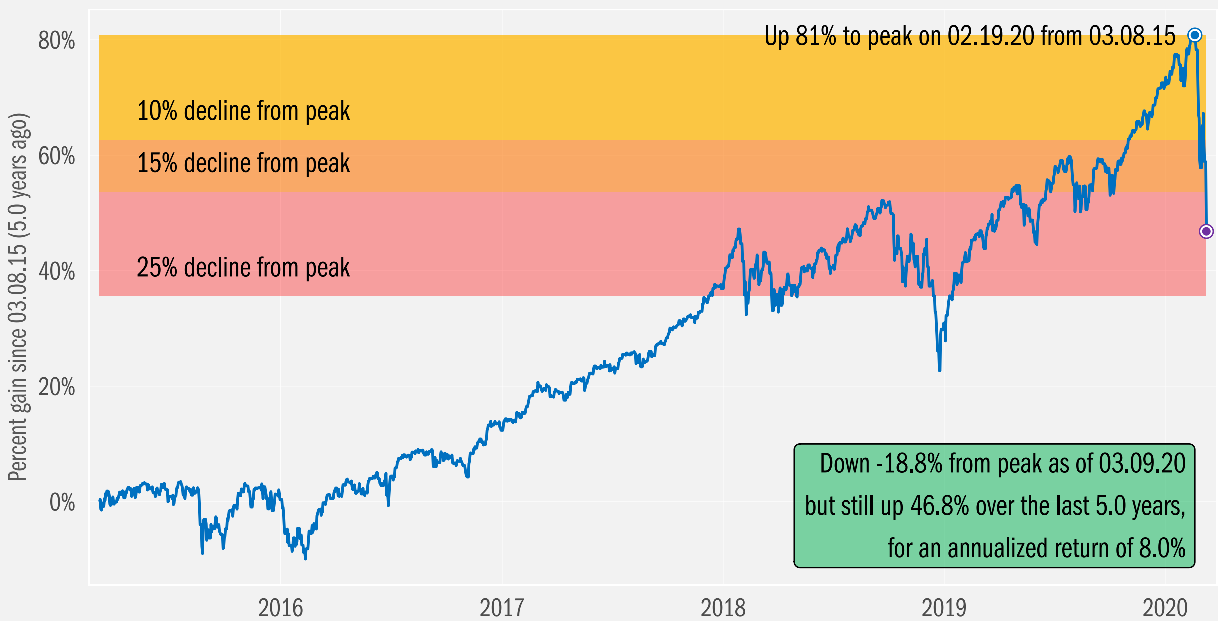
From 06.02.14 to 03.09.20 at 02:38PM. Value represents the current futures contract-based price per individual barrel of Brent Crude oil. Past performance is not indicative of future results. Investing in securities involves risk, including risk of losing some or all the invested capital. There is no guarantee that any investment or investment strategy will achieve its objective. Indexes are unmanaged. One cannot directly invest in an index. Index performance reflects the reinvestment of dividends, but does not reflect the expenses associated with the management of an actual portfolio. Please see additional important information regarding indexes at the end of this report. SOURCE: SRCM using data from Bloomberg

In addition, local and regional measures to contain the more quickly spreading COVID-19 virus brought forward the realization that the outbreak perhaps will have more dramatic macroeconomic effects than had been foreseen. The extent of the eventual weakness that is likely to ensue is yet unknown, of course. Estimations run up against the challenge of quantifying the effects of round-the-world self-quarantines in an era during which the workforce has become more flexible, but which also finds the domestic economy retaining a strongly retail-oriented underpinnings and increasingly globally derived fortunes.

Reaction Noted

With investors having had ample time to develop fears of the worst kind, U.S. stocks fell so sharply that a circuit breaker triggered, shuttering trading for a 15-minute window[1]. Rebounding upon the reopen, stocks fell anew, likely as estimators continued to fail at narrowing expectations for near- and even medium-term outcomes to the epidemic and the renewed battle for global energy dominance.

Figure 2: S&P 500 Index Total Return



From 03.08.15 to 03.09.20. Past performance is not indicative of future results. Investing in securities involves risk, including risk of losing some or all the invested capital. There is no guarantee that any investment or investment strategy will achieve its objective. Indexes are unmanaged. One cannot directly invest in an index. Index performance reflects the reinvestment of dividends, but does not reflect the expenses associated with the management of an actual portfolio. Please see additional important information regarding indexes at the end of this report. SOURCE: SRCM using data from Bloomberg

[1] Such intentional market closures were instituted after the 22.6% plunge in the Dow Jones Industrial Average on October 19, 1987. The first trigger occurs after a 7% decline in in the S&P 500 Index. Once markets reopen, were the S&P to fall by 13%, versus the prior close, another 15-minute close would occur. After reopening anew, were that index to drop by 20% on the day, the markets would close for the day's duration. There also now are decline-based triggers for individual securities, implemented after the "Flash Crash" in 2010.

What to Expect

This weekend's great expansion in reasons for worry is obviously not additive to our ability to predict the near-term future of investable markets. Indeed, that ability is as narrow as ever before. We do retain the belief that markets will remain volatile with emerging news of the COVID-19 outbreak, even as we maintain some hope that cooler heads shall prevail in the energy markets. With regard to the latter, however, there is a non-small chance that financial distress among energy firms spreads to banks and other financial entities, were the supply/demand dislocation to prove durable, spawning a contagion of a different sort.

Taken altogether, the near 19% decline from the peak in the U.S. equity markets suggests equity investors seem to have priced in a reasonably grand recession. There thus remains some room for the eventual slowdown not to prove so dire, with the equity market losses so far seen perhaps overdone. Meantime, yields across the U.S. Treasury curve seem to suggest global macroeconomic Armageddon. There lies an obvious mismatch. Our view is that the former is likely to prove the more useful benchmark. Regarding bond yields, however, the greater concern for us remains the vastly diminished expected return to be achieved via the relative safety of fixed income. Focusing on the longer-term, that is, we will continue to retain a longer-term focus, even as we seek to assist in the understanding of and foster endurance through this latest market downturn.

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The S&P 500 Index measures the performance of the large-cap segment of the U.S. equity market.

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