



COVID-19 and Oil Update (03/09/2020)

The Virus Concerns Continue and have now Impacted Oil

What is the updated Covid-19 situation?

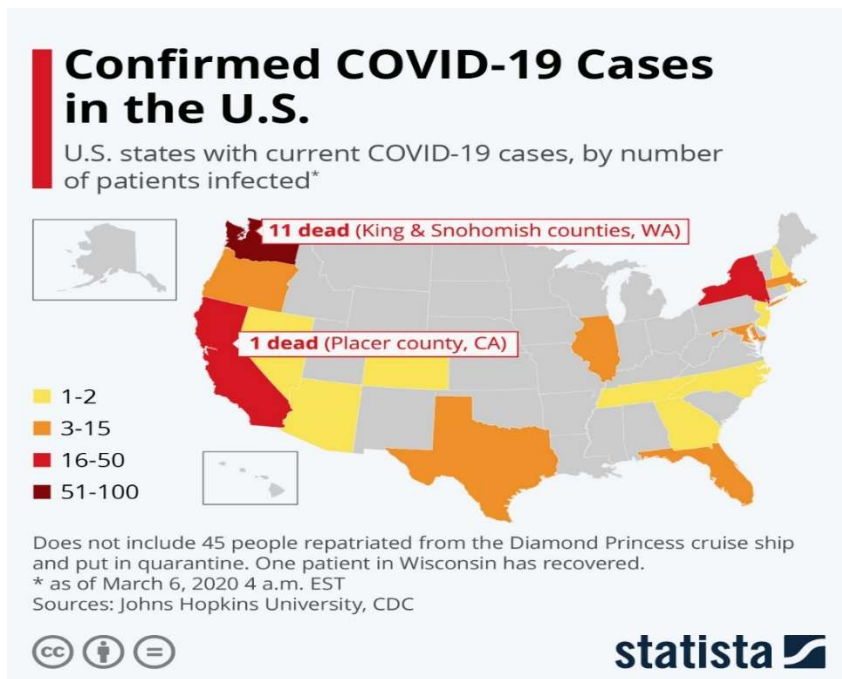
As of 03/09/2020 the global cases, status and outcomes are listed below:

Covid-19 Current Global Statistics (03/09/20)

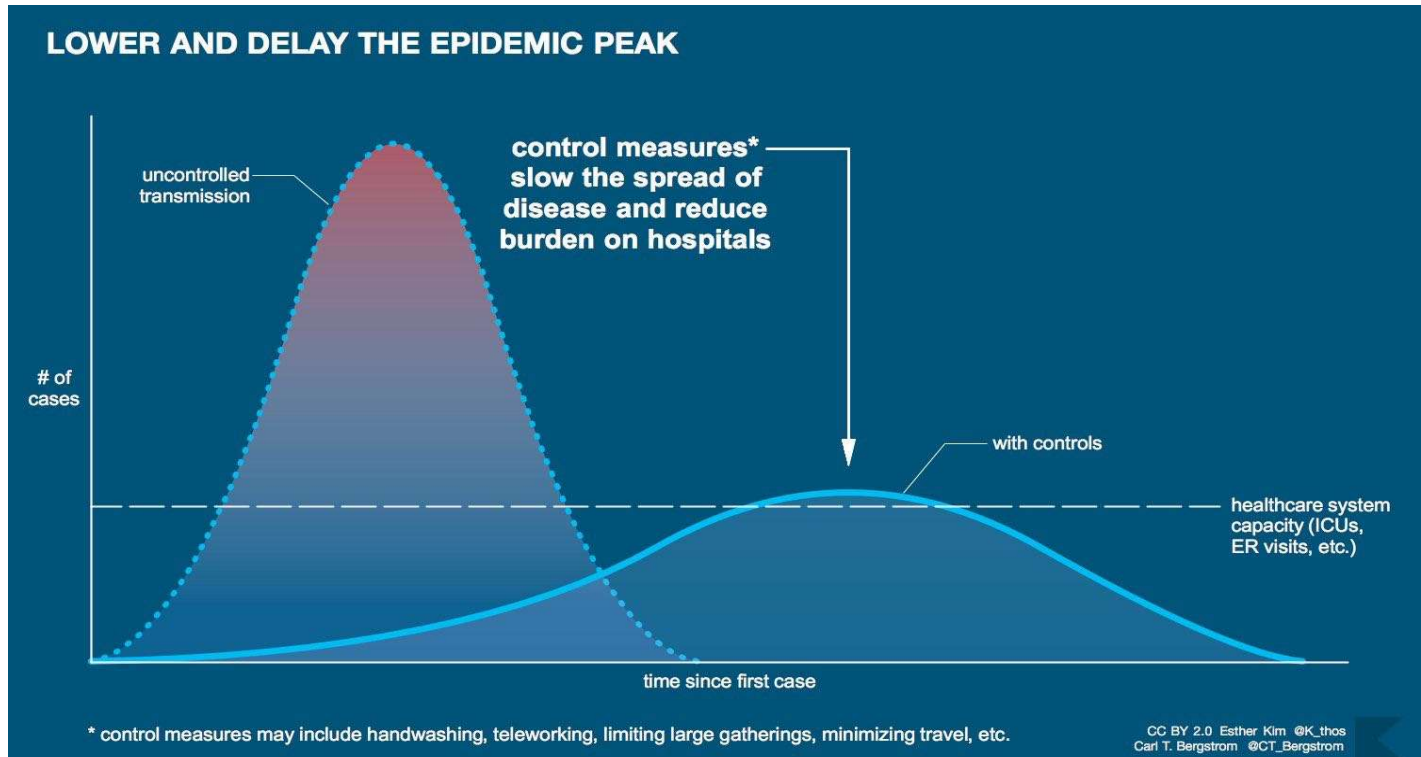
	Persons	Persons	Percent
Worldwide - Active Cases	45,143		
Mild Condition		39,160	87%
Serious Condition		5,983	13%
Worldwide - Closed Cases	66,610		
Patients Recovered		62,722	94%
Serious Condition		3,888	6%
Worldwide Total	111,753		

Source: Worldometer

As expected the numbers of infected cases continue to rise and peak infections may still be ahead of us as March and April were expected to see the spread of the virus which was recently discovered. Also, the rate of virus infections in China continues to fall whereas it is the rest of world that is now feeling the impact. Of the worldwide cases currently 92% of them are within the countries of China, South Korea, Italy and Iran. While China accounts for almost 72% of total cases alone it now represents approximately 1% of new cases.

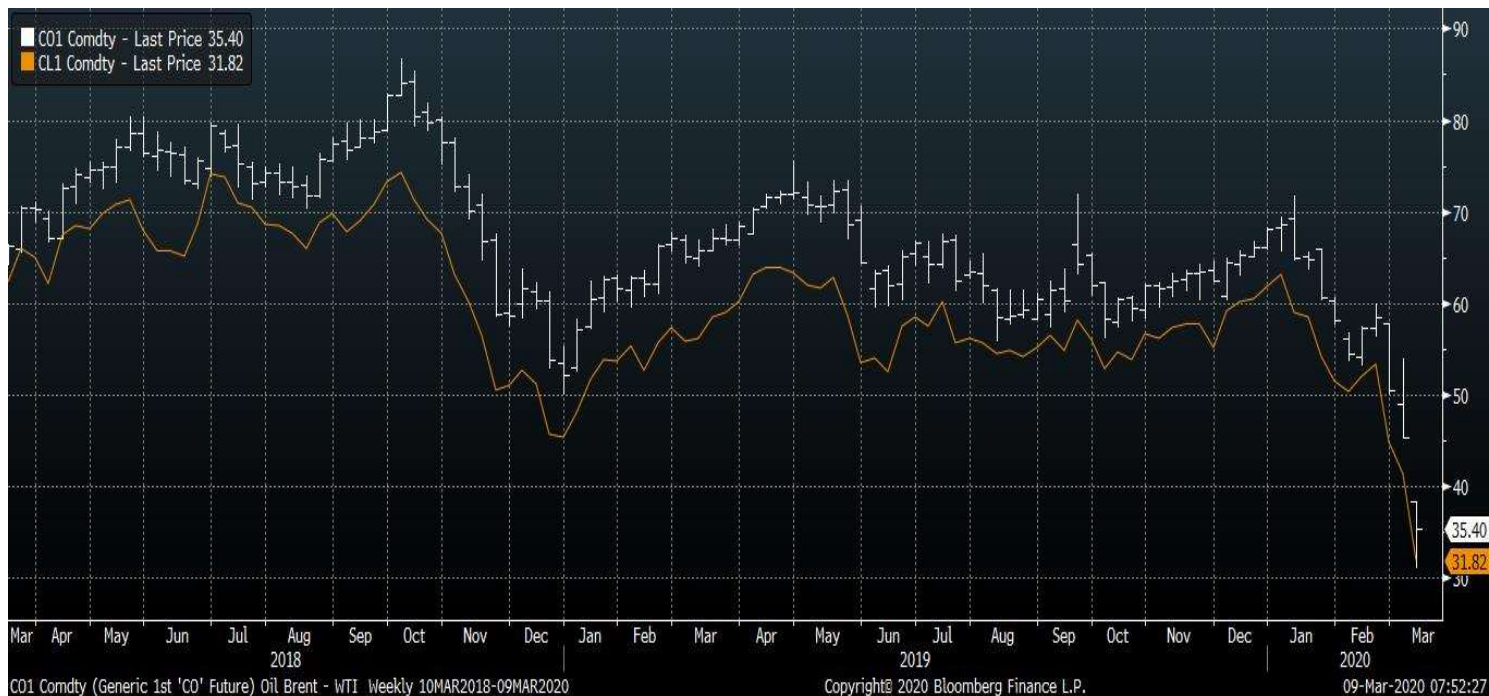


As you can see in the chart above the number of cases in the United States has now reached over 500 with approximately 22 deaths. The coronavirus situation should settle once the number of cases peak and begin to fall. The availability of diagnostic testing should help as the U.S. shipped 1.1 million test kits and the administration expects that many more will ship by the end of this week. The virus's global impact will be felt more deeply the longer it spreads in an uncontrolled fashion. Controlling the spread of the virus is critical both in lives saved and economic impact.



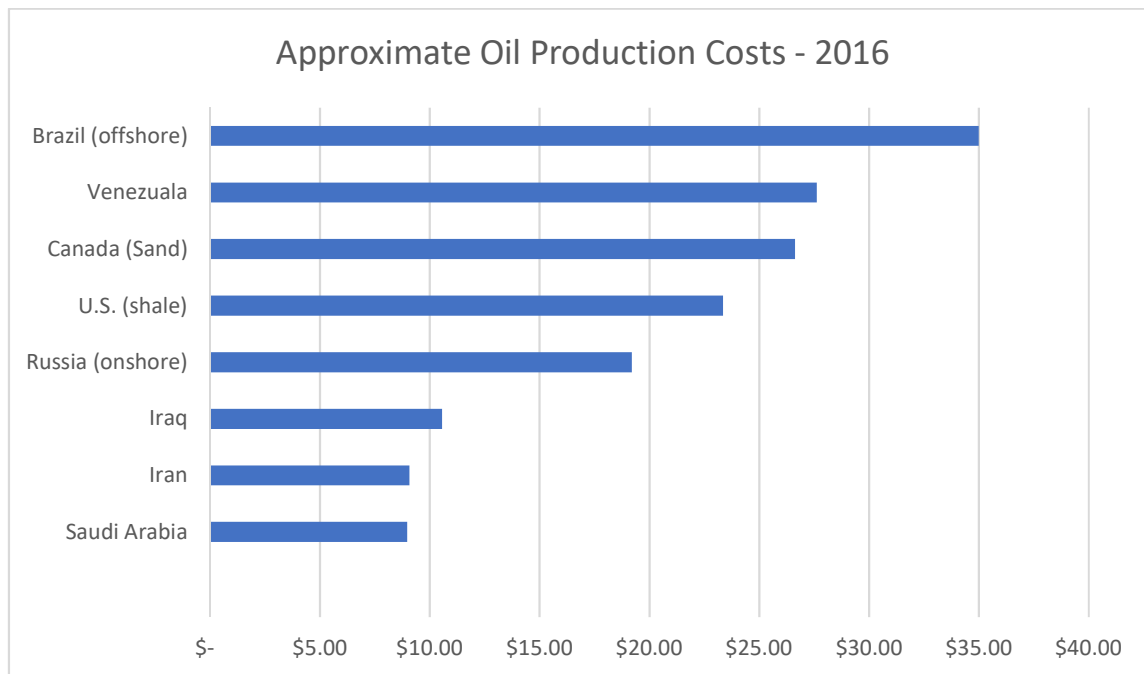
What is the economic impact?

The economic impact globally and in the U.S. will be most keenly felt in a drop-off in consumer demand. As consumers are quarantined in countries like China and Italy there is not much opportunity for them to spend. In other countries it can be more psychological as consumer confidence wanes and people simply decide not to spend or cannot spend due to quarantine-related missing paychecks. The lack of demand has hit certain industries like airlines, cruise lines, financials and energy particularly hard. This has manifested itself as geopolitical stress in the oil market. An oversupply of oil was already pressuring prices. The significant slowdown in demand related to quarantines and lower economic activity is now creating a greater demand/supply imbalance. OPEC tried to shore up oil prices by extending and increasing the agreed upon production cuts that are expiring April 1. Russia did not fall in line with the cuts of approximately 1.5 million barrels per day. This prompted a Saudi Arabia to plan to increase production and cut oil prices. As of this morning oil had fallen 30% - drops not seen since the outbreak of the gulf war in 1991. Brent was trading at \$35.40 and U.S. WTI at \$31.82 per barrel down from levels of \$75 and \$80 per barrel less than 18 months ago.



Source: Bloomberg

Given the ease of commodity access and a government-owned enterprise, Saudi Arabia is among the lowest cost producers in the world, so they can still make money on lower oil process better than most. On the other hand, the country's budget is built on a much higher price of oil, so it will strain government finances if it goes on too long. This stress on oil markets, especially energy producers and explorers, will affect American fracking companies as well as they are caught in the price war.



Source: WSJ (chart: author)

The latest economic indicators, which measured activity before the virus hit the U.S., saw the economy performing well. The United States demonstrated continued growth with the non-farm payroll jobs numbers released on Friday March 6th showing an addition of 273,000 new jobs and an unemployment rate of 3.5%. The most recent construction spending index and the non-manufacturing index numbers released last week both beat their consensus forecasts showing strength in those areas while the manufacturing index reflected a very slight expansion in that sector. The virus will create

economic headwinds, both globally and in the U.S., but the question is the degree of impact. More fragile global economies may not be able to weather this storm as well as a moderately growing U.S.

What has been the market impact?

The volatility of the markets and the rapid decline has been the order of the day since February. The S&P 500 was up 0.65% for the week on 03/06 but the daily volatility did not make it feel so. The number of 1%, 2% and 3% moves (up or down) in the S&P 500 has dramatically increased during the first 70 days of 2020.

S&P 500 Number of Significant Moves

	+/- 1%	+/- 2%	+/- 3%	Total
2018	44	14	6	64
2019	31	6	1	38
2020	7	1	8	16

Emotions and a repricing of risk (many which are not fully known) is causing the roller coaster in global equities. The Volatility Index (VIX) has spiked while the S&P 500 has fallen, and the 7% circuit breakers were tripped during the day on 03/09.



Source: Bloomberg

The fear has also impacted interest rates as the flight to high quality assets, like US treasuries, has caused the 10-year Treasury bond yield to fall to below 0.5% - a historic low. This makes all real rates (after the effects of inflation) negative. In fact, not only has the 10-year rate fallen dramatically but the entire U.S. yield curve is under 1.00% as of this morning. The FOMC has reduced fed funds by 50 basis points (target rate below). At least the U.S. 10-year rate is still positive, unlike Germany and Japan, which are back in negative territory.

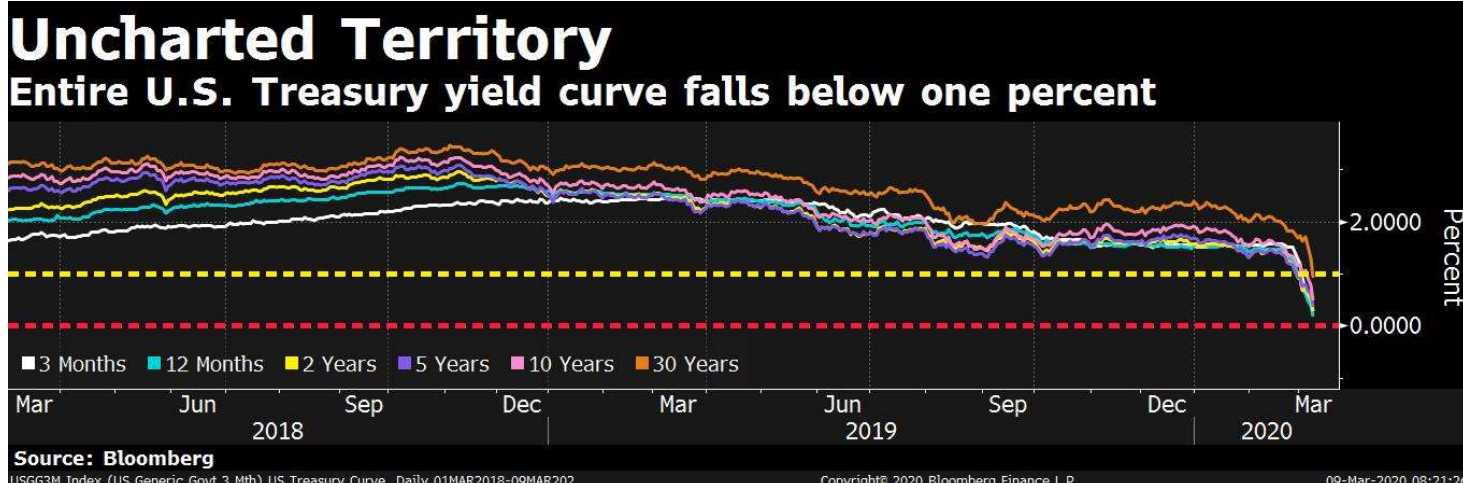


USGG10YR Index (US Generic Govt 10 Yr) US 10 Yr; US 2 Yr; Ger10 Daily 10MAR2019

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Source: Bloomberg



As the virus continues to dominate the news flow, we expect the markets to be choppy as they reflect the updates about the virus situation. We are watching to see what additional monetary policy and liquidity actions the Federal Reserve may take and to what extent the federal government considers fiscal stimulus. Looking back at the ten or so other recent significant health events such as SARS, Zika, MERS, and others, the markets have been negatively affected by those pandemics, but they have been quick to recover. In eight of the ten events stocks climbed more than 10% after twelve months and in the twenty-six market corrections of at least 13% since 1946 it has taken an average of around four months for the markets to recover to their pre-correction levels but, that is just history.

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