# The Market in Review

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### This week's articles and insights

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**Wife: Did I get fat during Quarantine?**

**Husband: You were never really skinny.**

**Time of death: 11:45 a.m. on 4/30/2020**

**Cause: Coronavirus**

### Your Index Report

| | Current | Last Week | Year-to-Date |
|---|---|---|---|
| Dow Jones Ind. Avg. | 24,346 | + 3.53% | - 14.69% |
| S&P 500 | 2,912 | + 4.10% | - 9.85% |
| TSX | 14,781 | + 3.72% | - 13.38% |

## Negative Oil and a Coffee Story

Years ago, I sat beside a commodities trader in my brokerage firm's bullpen. He arrived for work every day at 5:15 a.m. for the grain market open and left at 1:15 pm sharp when gold futures closed. In the 1980s, almost all commodities settled with physical delivery. In other words, if you owned the contract on the day it settled, you owned the commodity.

He had one active client who was long coffee futures as the Friday settlement approached. He left several frantic messages for the fellow who had forgotten and was out of town. The market closed and the broker sat at his desk, wondering what to do. Finally, the client called back and my friend explained the pickle they were in.

"Commodities settle with physical delivery. You just took delivery of one contract of coffee."

"I thought the contract just expired!" the client exclaimed (I could here his voice even from my side of the desk). "How much is a contract, anyway?"

"37,500 pounds. About 300 sacks. Picture a railcar on a train. Half of one of those," my friend replied.

"A RAILCAR? What am I going to do with a trainload of coffee?"

To be honest, I was now wondering the same thing. Ever the salesman, my friend had a suggestion.

"Well, you're going to need something sweet to mix with it. Why don't you buy some sugar?"

Strange things happen during times of crisis. Last week, oil prices fell to -$37 per barrel.

Why? For starters, we used 100 million barrels of oil per day just a few months ago but are down to just 70 million barrels with jets grounded and cars idled. It is also because of an oddity in the futures contracts.

An increasing number of oil barrels are now traded like stocks. You own a digital piece of paper but nothing you can hold in your hand. Here's the problem: West Texas Intermediate Crude Oil contracts settle physically in Cushing Oklahoma –

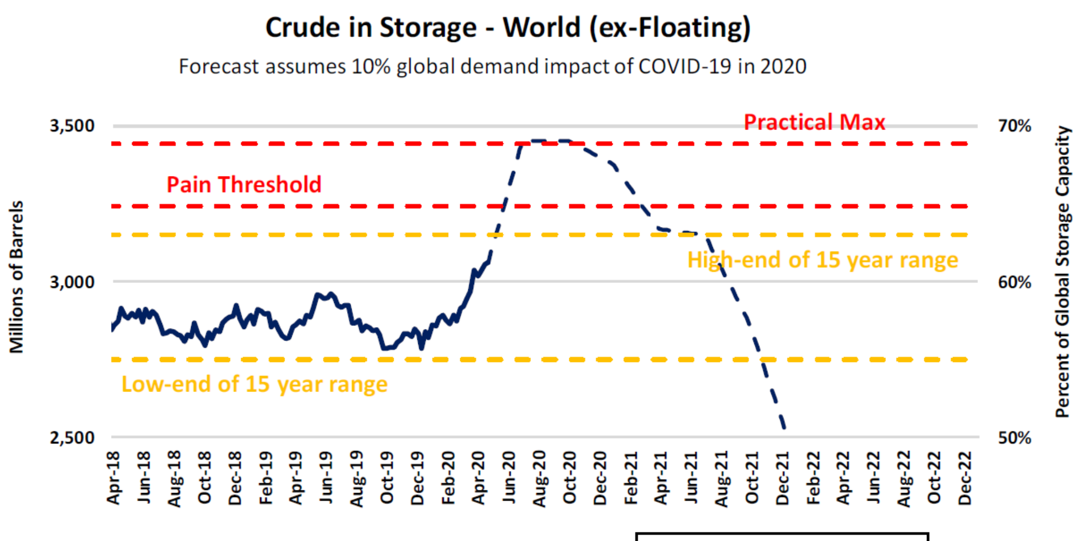
one of the last commodity contracts in the world to settle with actual delivery. Some owners of these contracts got trapped with billions worth of energy futures that expired in days. You need to have a pipeline, a railcar, or a storage tank ready because the black stuff is yours the moment the contract settles. But, because of the pandemic, there is literally no storage available anywhere. And Cushing is landlocked, so ocean-based oil tankers are not an option.

In the final two days of the contract, desperate owners were literally paying unknown buyers $37 per barrel to take the contracts off their hands. It is rumoured the buyers were refineries, who have storage and can hold the crude oil for processing into gasoline in the next three months. Whoever it was did quite well.

The collapse in oil prices have sent reverberations around the world. Alberta, North Dakota, and Texas are seeing rigs laid down and wells shut in. Russian and Saudi Arabian budgets are deep in the red, and oil traders (see above) have lost billions on trades they barely understood. In time, enough production will stop so that the market will balance.

Oil wells can be very difficult to restart once they are stopped, however. When pressure is lost, fields can be irreparably damaged.

Energy supply and demand are like a pendulum – they never stop in the middle. Our analysts foresee shortages developing as early as 2021. If we cut back to 70 million barrels of production and the world returns to using 100 million barrels, prices will rise:



**Source:** URSA, Raymond James research

For now, expect to hear of energy company bankruptcies and oil storage being full everywhere. It is the inevitable result of the sudden oversupply brought on by the pandemic. Much more oil production needs to stop before the market can balance itself once again.

And what about that unwanted trainload of coffee?

My broker friend called the commodities exchange and explained his client’s situation. Apparently, getting stuck with a delivery was more common than he thought, and the agents there kindly arranged for weekend storage. The 300 bags of coffee were placed in an upscale warehouse until they could be resold on the following Monday.

It was the most expensive coffee this fellow ever owned. And no, he didn’t buy any sugar, or coffee again, for that matter!

## Irresistible Force, Immovable Object

Photo by Marcus Woodbridge

On one side of this crisis, we have the worst economic contraction since the 1930s. Unemployment could exceed 15% in the US, many commercial landlords were lucky to collect 50% of their rents for April, and oil prices went briefly negative.

On the other side, we have an unprecedented amount of central bank support around the world. Between interest rate cuts, expanded unemployment insurance, tax concessions and extensions, global stimulus is estimated to be over US $8 trillion. We have never seen so much money created in such a short time in history. So far, this giant safety net has prevented markets from collapsing and permanent job losses.

It will be a long battle. Which side wins? Whatever happens, the impact on stock and bond markets will be profound.

Our stance so far has been to wait for the end of the “sugar-high” of stimulus to wear off before doing more buying. The problem has been the sheer amount of “sugar” thrown at this market. Central banks around the world have been buying government bonds of every type, plus corporate bonds and municipal bonds. Some countries have even bought stocks to prop them up.

And this isn’t new. Central banks have become more and more interventionist since the 1990s when the US Fed bailed out Long-Term Capital Management in 1998. As a result, investors have been conditioned to *Buy The Dip* whenever stocks decline because the Federal Reserve will rescue us from any bear market.

The problem is, economies and stocks have to decline sometimes. As the old Fram oil filter commercial said, “*You can pay me now or pay me later*.”

History suggests waiting is still a good idea. The average time it takes to reach the bottom of a bear market is 18.8 months. We just set new highs 2 months ago.

**Bear Markets & US Recessions**

| **Peak** | **Trough** | **Peak to Trough (Mths)** | **Return** | **Time to return to previous peak (Mths)** | **Days to 20% recovery from trough** |
|---|---|---|---|---|---|
| Dec-61 | Jun-62 | 6.5 | -28.0% | 21.0 | 163 |
| Nov-68 | May-70 | 18.1 | -36.1% | 39.8 | 121 |
| Jan-73 | Oct-74 | 21 | -48.2% | 91.5 | 33 |
| Mar-00 | Oct-02 | 31 | -49.1% | 64.9 | 43 |
| Oct-07 | Mar-09 | 17.2 | -56.8% | 66.1 | 14 |
| | | | | | |
| **Average** | | **18.8** | **-43.6%** | **56.7** | **74.8** |

Source: FactSet, Raymond James Ltd.

And we aren’t alone.

A recent survey by investment firm UBS said “The majority of the world’s wealthiest investors are waiting for stocks to drop further before buying again, on concerns about the pandemic’s impact on the global economy. 61% of respondents want to see stocks fall another 5% to 20% before buying.”

Of course, if this is the majority view, the crowd may be completely wrong and it is smooth sailing ahead.

Our belief is that the swift actions of global central banks have cushioned the world from a severe recession. And rapid advances in antiviral drugs and vaccine therapies suggest we may have a permanent solution to the coronavirus sooner than first thought. The recovery will take time, however. Early reports from China show that even with restaurants and malls open, few are visiting. They are either afraid to enter small spaces with other people, or hoarding their money after not working for months.

It will just take some time.

## Fear of Missing Out (FOMO)

There is a pattern to how stock sectors rotate in a recession.

First, the "bunker stocks" outperform. These are the utilities, grocery stores, health care, and sometimes gold stocks. We certainly saw this in March as these were all the leaders. There were a few outliers, such as Amazon (**NASDAQ AMZN**) and Zoom Video Communications (**NASDAQ ZM**) but the winners were few.

In the second stage, the "early risers" take the baton. These are railway and industrial stocks, for example. They don't need a vibrant economy – just a stable one.

Finally, the most cyclical stocks take over, such as energy, financials (banks), leisure (cruise ships and airlines), as the economy ramps up.

This huge rotational cycle normally takes months or years to play out. *In 2020, we have seen it all in 5 weeks*. How much of the current rally is based on fundamentals and how much is based on the ocean of new cash looking for a home? How much is based on investors' fear of missing out on the sharp rally?

We do have to remember that the May-to-October period is better for the "bunker stocks" in most years (hence the saying "Sell in May and go away"). Could it be different with many countries starting to open up?

Initially, we will see a surge in haircuts and shopping. This happened in China when they relaxed their quarantines. However, as mentioned above, people in

China are still wary of stores and restaurants. This suggests the recovery will take longer than many expect.

So, while we are happy to see stocks higher, we are sticking to our plan. Stocks will experience periods of weakness ahead, and that is when we'll put more money to work.

## What Will Change?

A month ago, we predicted the end of the handshake. Today it is not uncommon to get stinkeye from strangers for just walking within five feet of them. Handshakes are definitely not going to be common going forward.

With so many people at home in sweatpants and t-shirts, we recently wondered if business suits – and especially ties – are also on the wane. Marks and Spencer, the big UK department store, reported that sales of ties were down by nearly 6% while suit sales fell by 10% <u>before</u> the crisis. Will the pandemic kill the tie off for good? Or will men be rushing to dress up after months in the basement, especially if they are headed to a job interview? We certainly see fewer ties around men's necks these days, so our bet is that this only hastens the decline.

What else are permanent changes? Mobile ordering or order-and-pick-up is now here to stay. Grocery stores have been trying to get people to embrace on-line groceries for years with little success. Now, millions are doing it and liking the convenience. Door Dash and Skip the Dishes are now household names for restaurant deliveries.

In the office, expect to see more people shift to permanently working at home, at least part-time. Open offices may return to cubicles with plexiglass barriers, thanks to the coronavirus. There will be more empty offices in the next year, and maybe for longer.

China's long growth boom is over. Many products that were made in China will now be made much closer to home. We turned our health care system into a just-in-time model that broke down completely. We will want our factories closer and more supplies will be stockpiled. Tensions between the US and China will increase as both point fingers at the other for the pandemic.

Oil is a coin toss. On the one hand, we may see a permanent decline as more people discovered they can live just fine with less travel. On the other hand, cheap energy increases usage. Canada will have to adapt in many ways. Our energy sector was built around the just-in-time model with every drop of oil produced shipped for immediate consumption. The oil glut revealed a critical need for long-term storage, so expect tank farms or salt caverns to be adopted in the future.

Feel free to suggest any permanent changes you see on the horizon.

## The Task of Finding a Mask

This week, Southwest Airlines (**NYSE LUV**) - the US airline that inspired Westjet in Canada - announced that passengers would be required to wear a mask on all flights in the immediate future. In most parts of Asia, it is standard practice to wear a mask whenever you leave the house or go shopping now. It is the new social etiquette.

How long before we see that here? The majority of North Americans are not wearing masks, but they certainly are in New York City and other hard-hit areas. Expect that it may be required in the near future.

We are blessed with relatives who are outstanding seamstresses. If you need a custom-made, double-layered mask, send us a note. We would be happy to arrange one for you.





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*Prices shown as of April 30th, 2020*

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