RMH Investment Management, LLC

Market Watch with RMH

The Rubber Meets the Road

The Rubber Meets the Road

What a great saying, others include:

- "put up or shut up"
- "go big or go home",
- "the moment of truth"
- "let's get this show on the road"
- "go down that road"
- "the first leg of the journey"

They all mean the same thing, the economy is opening, and we are going to find out if this was the correct decision. On one hand, we have the medical community and all of its supporters saying; we must stay quarantined until it is 100% confirmed the covid-19 infections are going down and that we have enough testing kits to test a very large swathe of the population. On the other hand, the business community and workers want to go back to work as they are fearful of a rather severe outcome of business/job failures and all that it entails! **Finally, there is the silent cost not talked much about**, illnesses not getting treated, postponing necessary elective surgeries, children not at school…, domestic abuse cases going up, and this is a partial list only.

From the McKinsey article: "**Crushing coronavirus uncertainty: The big "unlock" for our economies**", the chart below shows that confirmed lockdowns cause deep economic shocks. The developed economies are likely to see Gross Domestic Product (GDP) decline by 8% - 13% in the second quarter of 2020. By the end of April, more than 20.5 million jobs had been lost in the U.S. since the start of the pandemic.

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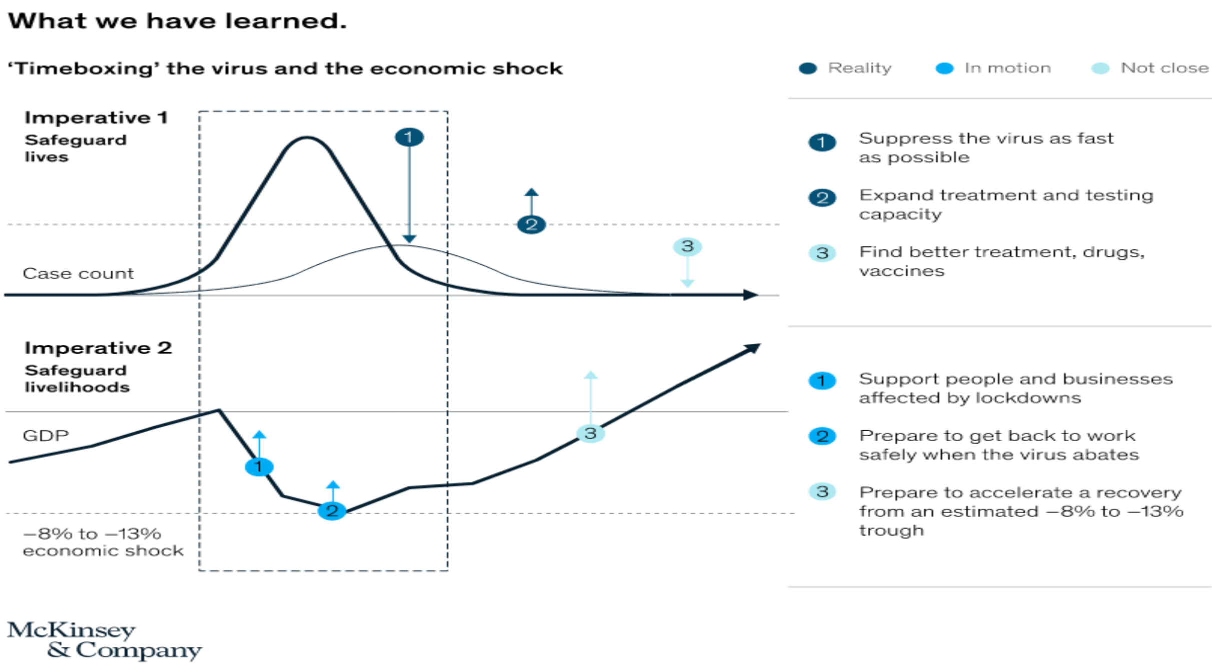


Eight weeks ago, the country worried about the supply of ventilators, and critical care capacity, the world's ability to suppress covid-19, and how governments would respond to the economic pandemic. Fast forward eight weeks, we now know we can curb the spread of the virus, we can rapidly expand critical care, and are on our way to rapidly expanding testing. We have seen most governments and central banks move rapidly to implement stimulus and liquidity measures to cushion the economic shock.

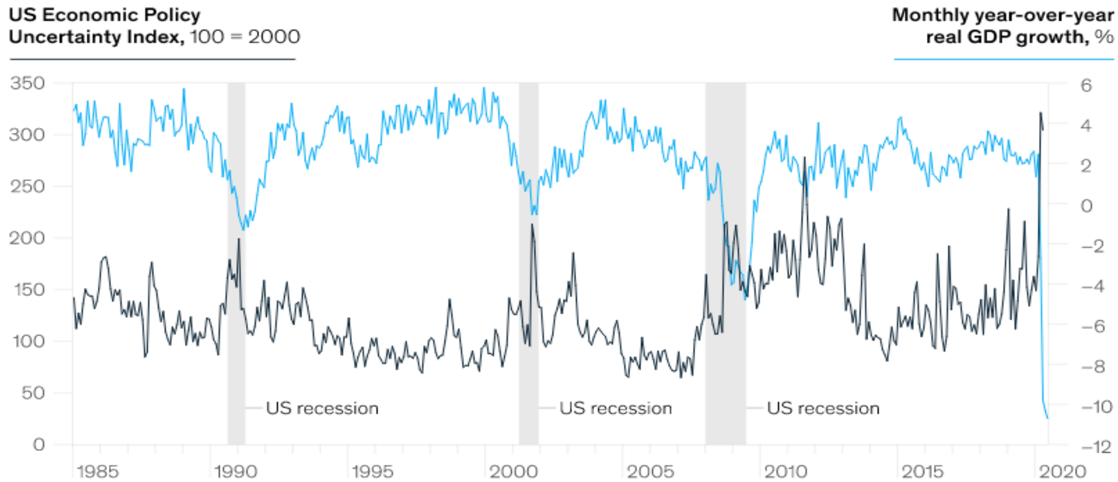
McKinsey surveyed global executives asking how long they believe their economies will take to return to precrisis levels, and the responses ranged from three quarters to five years. When consumers were polled with the same question about when they could expect their lives to return to a similar level of normality, answers ranged from months to years.

Uncertainty is the real problem for our recovery and it is toxic. This uncertainty about the continuing spread of covid-19 makes people fear for their health and lives. Uncertainty about livelihoods makes them cautious about spending. Under high uncertainty, business leaders find it impossible to make plans for investment.

The objective now must be to crush uncertainty as soon as possible. Covid-19 has created the highest level of uncertainty in 35 years**. From the chart below, when uncertainty subsides, confidence returns**

and the economic recovery starts.

As uncertainty goes, economic growth returns.

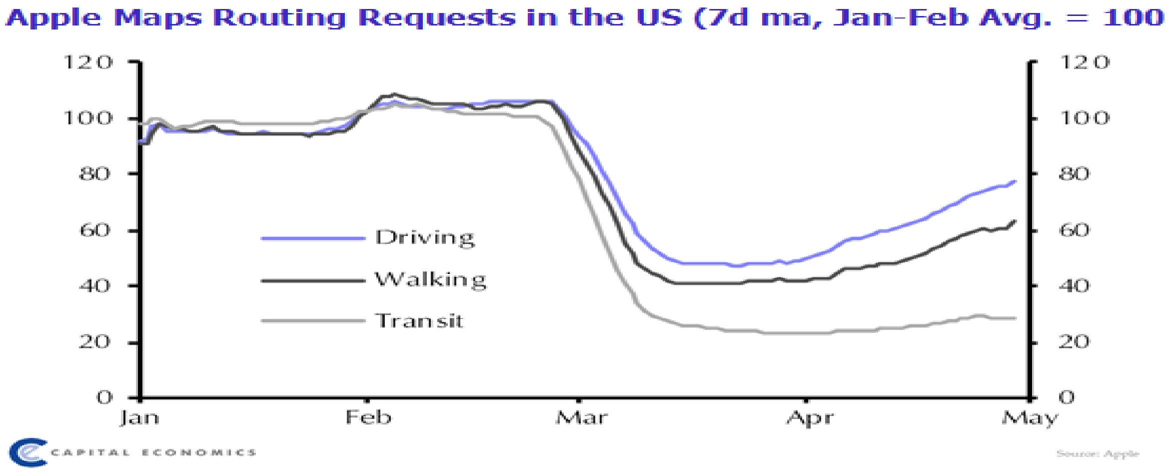


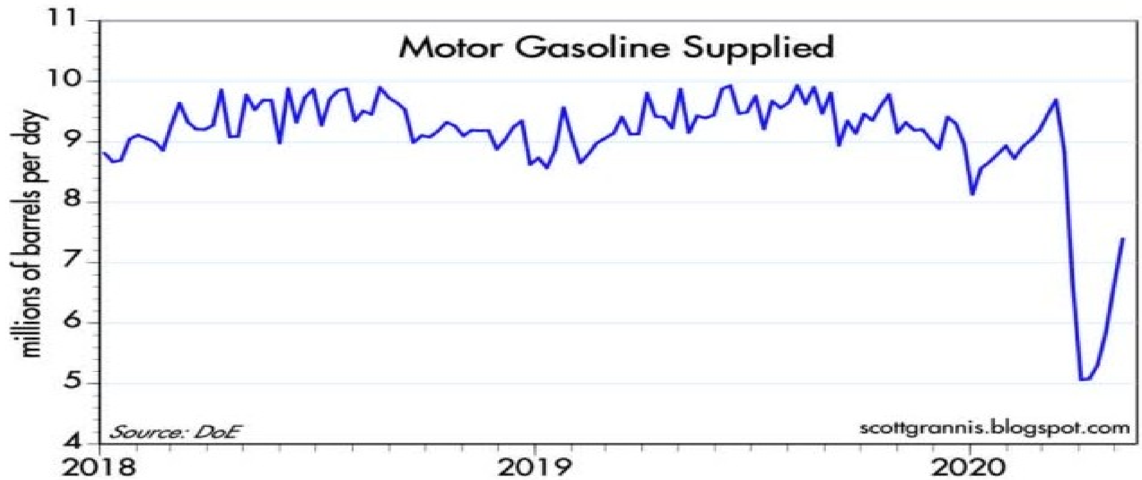
Note: Policy-uncertainty index available through April 2020; April–June year-over-year real GDP growth estimated based on −10.3% contraction in McKinsey A1 scenario projections.
Source: Scott R. Baker, Nicholas Bloom, and Steven J. Davis, "Measuring economic policy uncertainty," Economic Policy Uncertainty, policyuncertainty.com; IHS Markit/Macroeconomic Advisors; McKinsey analysis in partnership with Oxford Economics

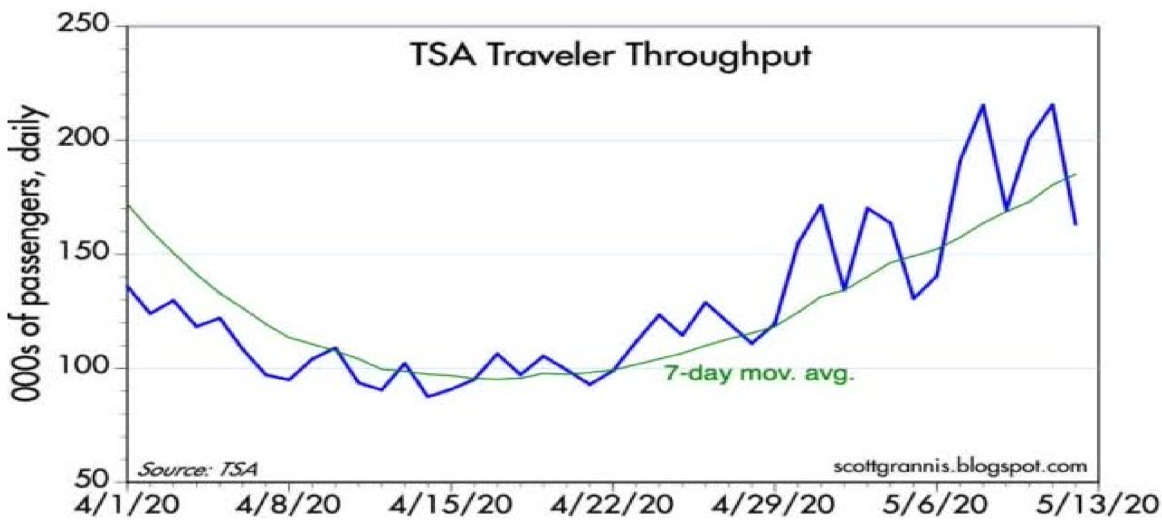
McKinsey & Company

In conclusion take the uncertainty away, as people identify with their job, they identify with working, and most people want to work. It gives them a purpose, something to do. Take that away and you have a problem.

We are seeing signs the economy is starting to reopen, and as you all know, pictures are worth a thousand words.

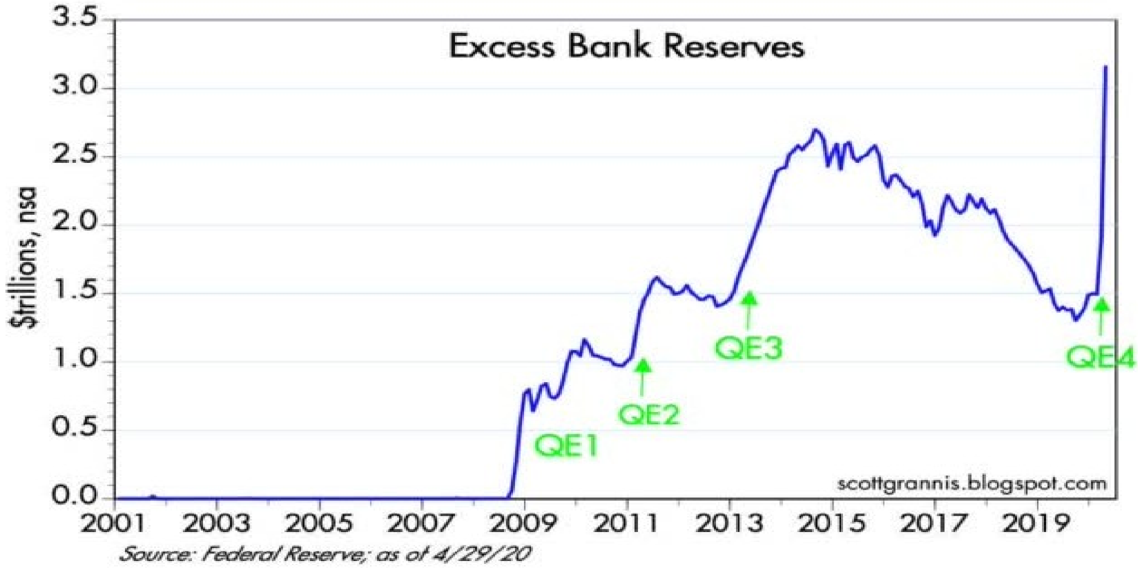






Prior year average, same period: 2.34 million

Chart #11



The chart above with regards to the excess bank reserves is an interesting chart in my opinion. This shows how much bank deposits have grown since mid-March, as the demand for safe money soared as a result of covid-19. Savings deposits pay little to no interest, so people only hold these deposits if they value safety and liquidity far more than their yield. As we mentioned above, this was the uncertainty trade.

From the McKinsey article mentioned previously, "…we need to crush uncertainty and rebuild confidence to avert structural damage to the economy – and do it fast. Lives and livelihoods will depend upon it".

Energy: Where the Rubber met the Road

The spat is officially over, meanwhile the U.S. energy petrochemical complex got blindsided, a number of companies had to furlough workers, and reduce capital expenditures (the drilling/pumping for oil and natural gas). A bad month.

Well what did we learn that we did not already know? **Nothing.** Russia cheats on its allocation with regards to OPEC; the Saudi's finally called them on their bluff and crashed the price of oil globally. Fast forward to now, the Saudi's announced they were cutting production by 1 million barrels or so, same for the Russians. The U.S. production dropped by serval millions barrels as companies announced cuts to their production budgets. Why, uneconomical to produce. When the price of oil/natural gas goes back up the U.S. and others not in OPEC will produce more.

What else did we learn?

- Saudi's raised the Value Added Tax from 5% to 15% for their citizens, and mentioned the word austerity. Last time austerity was tried in the Middle East, 3 regimes toppled. Stay tuned. In addition the Saudi's were blowing a huge hole in their reserves with their unsuccessful foray into the $15 barrel range. With regards to the Saudi fiscal expenditures on their citizens, it is estimated they need a price of $80.00 per barrel to breakeven. Add in their military purchases, the ongoing war in Yemen, and other adventures, they probably need a price north of $100/ barrel.

- The Russians need an estimated price of $60.00 per barrel for their fiscal needs for the population they support. Add in the military costs of Eastern Ukraine, Crimea, and last but not least Syria, they will need at least $80.00 per barrel at a minimum. In addition the Russians can't borrow as cheaply as the Saudi's (due to U.S. sanctions), and they have a major covid-19 problem that they ignored.
- The following countries need well over $100/ barrel to break even for their domestic fiscal expenditures, Iran, Iraq, Venezuela, Nigeria, and others. The price was going up one way or another.
- It is always best to diversify away from reliance on the model of natural resource royalty income. OPEC and all of the other countries that rely on this model are one scientific discovery away from realizing they have a lot of stranded assets in the ground that are almost worthless. Solar and wind is proving this. In the future when there is a major breakthrough in battery storage technology, the price of oil /natural gas will fall dramatically again. We have not even begun to have talk about Fusion as an energy source.

In conclusion, the price of oil will slowly find its way higher ($30 - $40 maybe, I doubt it will go higher than these levels), the U.S. petrochemical complex will continue to survive and prosper, pipelines (midstream assets) will go back to moving fluids, and the downward price movements to these stocks will have proven to be a good buying opportunity (Blackstone took a 7.0% stake in Energy Transfer, among other midstream asset purchases). **Betting against the U.S. petrochemical industry that relies on market pricing is never a good idea with all of the human ingenuity that exists in these companies.** Financier Henry Clews in a 1918 letter wrote, "the best cure for high prices is high prices". The related saying "the cure for low prices is low prices", works as well. Looks like the market will be setting the price for the next while and the U.S. will be the swing producer.

Things that we are keeping our eyes on include the following:

- Will there be an infrastructure bill to benefit the country including 5G infrastructure for the wireless economy, will we get better infrastructure (speed) for the moving of data, will we fix our roads and bridges, create jobs to just name a few. It is really cheap at present to borrow for significant long term investments, 30/50/100 year U.S. Treasury bonds?
- What will happen with insurance companies sued by their clients for business interruption or similar? We are thinking covid-19 was not part of the insurance coverage.
- What will happen with companies that are sued with regard to covid-19 and non-safety of employees?
- The insurance question(s) is particularly troubling, we need to get this right.
- Is all well in China? What does the future hold? Lying about the severity of covid-19, covering it up, generally leads to a price to pay. What will that price be? A lot of countries have paid or will pay a dear price, not to mention the individuals and their families in those countries.

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What steps are we doing at RMH?

- We are looking at the portfolios and rebalancing where necessary.
- We are taking advantage of tax loss selling to lower future capital gains.
- We are looking at what insiders are doing with some of the stocks we have purchased.
- We are talking with portfolio managers on a one to one basis and participating in conference calls.

If there are ever any topics you wish us to explore, please let us know. ***We are here to help and guide you through these times.***

We thank you all for taking the time and reading “Market Watch.” It is meant as an educational piece on the always evolving markets. It is something we plan on providing every month, and your feedback is very important to us.

On a personal note, RMH is now in the position to bring on new clients and please be sure to share this informational letter with whomever you wish. RMH’s focus is on the customizable investment needs of individuals, families, and foundations. We enjoy working with our clients to better understand their goals, values, and passions for what is important in their lives. In expanding our client base, we look forward to working with people who share these same desires

Richard Mundinger, CFA

Sources include the following:

Capital Economics May 15, 2020 Coronavirus Daily Alert
McKinsey May 13, 2020 Crushing coronavirus uncertainty: The big “unlock” for our economies
High Frequency Data Show A Strong Rebound: Calafia Beach Pundit, May 14, 2020