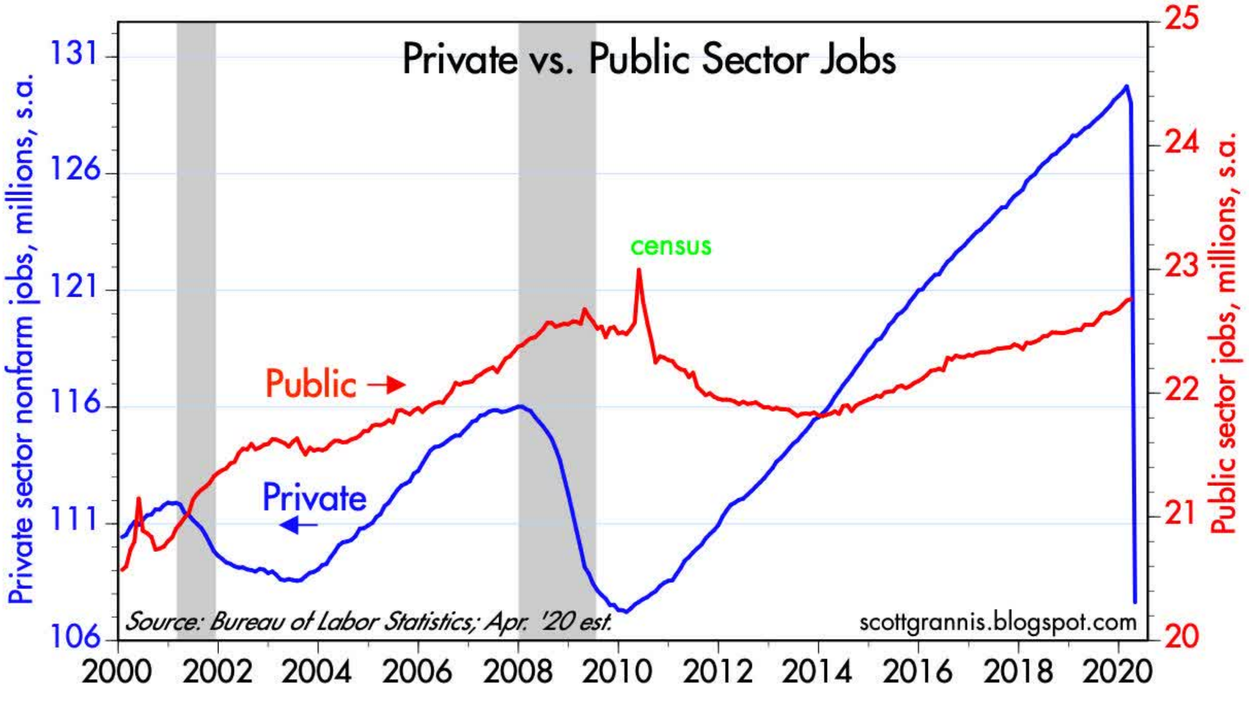
Market Watch with RMH

What keeps me up at night, Oil with a negative price, 2020 1Q &2QEarnings Credit Markets, the opportunity, Federal Reserve, Retail Sales, Energy Comment and COVID-19 stats

What keeps me up at night?

An interesting question. During the 2008 – 2009 Great Financial Crisis (GFC), the fact the big U.S. banks might go bankrupt, definitely did. I only realized the significance when I spoke to one of my friends in Toronto, who was a SVP for one of the major Canadian banks and he let me know they were not trading with their peers. I vividly remember mentioning, lower leverage (18x for Canadian Banks vs. 35x leverage in the U.S., and 50X for the E.U.), a retail branch system numbering in the 2,500 + range, meant they had very little to fear from losing deposits, hence going bankrupt. The answer was **"correct, we are still not trading!"**

Looking at the chart below, the loss in the private sector jobs and the 4-5 years it took to get them back is a concern. Back in 2008 – 09, it seemed to me the government was happy with 10% unemployment, as they moved **VERY** slowly. Now we have the benefit of what worked and what did not in the GFC (the pandemic caused the current financial crisis), and the government was very fast to act this spring. I think at a pace that surprised everyone. Furthermore, small businesses make up over 50% of all the jobs, and the risk of a number of them not coming back is very real! We have already lost our favorite Carniceria, and a strong possibility of several fitness businesses not reopening.



Why did the price of oil go negative?

This was a big surprise and spooked the market as it took time to figure out. The simple answer was as follows:

1) If one is holding a contract at expiration, **one must take delivery!**
   a. Each contract is for 1,000 barrels.
   b. **Delivery is in Cushing Oklahoma**.
2) The "professional" investors (institutional traders were out of the month of May market) were already looking at the next month's contract, June.
3) This left retail investors (in the U.S. and abroad) who sometimes invest, not knowing the details, and here is where it gets crazy.
   a. There were over 3,000 **Chinese** retail investors who were in this contract.
   b. Marketed as "crude oil treasure" by the Bank of China, marketed as a Wealth Management product, that could be purchased through the Banks app on their phone, for as little as $61.00.
   c. Other Chinese banks had similar products, their expiry dates were different.
   d. The Chinese Government forces the domestic banks to have negative interest rates for savings, hence depositors speculate to get a higher return. **Worse**, while the investors who lost money and had pledged assets against these losses, it is unlikely the Bank of China will seek those assets (bailed out by the Central Bank?). Wouldn't that be wonderful here?
   e. Investors in Korea and Hong Kong have exposure to $1.1B in structured notes tied to the price of West Texas Intermediate (WTI).
4) Carl Icahn, (through his hedge funds/companies) was rumored to be buying all of the negatively priced oil he could, as he had capacity to take delivery. Nice profit.

First Quarter 2020 Earnings and Expectations for the Second Quarter 2020

First, expect chaos, second forget. Quite simply, January and February of this year were normal; however March is where all of the problems started, as the nation shutdown to battle COVID-19. Looking forward the earnings have pretty much all been withdrawn by the companies, and any estimates will be meaningless until the country starts to go back to work. **One hopes sooner, rather than later in RMH's opinion**.

The real reason for forgetting earnings and expectations is that a number of so called experts get asked their opinions. It seems the more outrageous they are, they get recognition, and then the press runs with that story. The sad thing with this is that there is **ZERO accountability**, and rarely a retraction for the angst they have caused. Take care with what you read or watch. All **RMH clients** know not to watch the TV for their news as this will raise their blood pressure (just kidding with some seriousness to it).

Credit Markets

Over the last month there have been a number of dislocations in the pricing of debt across all asset classes. The following table shows the spreads and the likelihood of return looking out 1 – 2 years.

What we are thinking is that it is folly to try and time the bottom. Price recoveries tend to be very dramatic, just like the downside movement of prices in late March of this year. Adding funds to these strategies over time looks to be a prudent fixed income strategy.

Spread . Level	1-Year Forward Return	Probability of Positive Return	2-Year Forward Return	Probability of Positive Return
<500	2.62%	87.0%	6.52%	91.3%
600<	19.82%	100.0%	28.69%	100.0%
700<	29.89%	100.0%	42.83%	100.0%
800<	36.02%	100.0%	49.56%	100.0%
900<	38.14%	100.0%	51.99%	100.0%

We receive a number of shareholder letters, of which the one from **Baron Funds** caught our eye with some good tables. The table below showed investors adding to their positions all the way up to February 19th, 2020. Then a dramatic reversal of taking funds out of the markets in the following month as this exacerbated the downside, selling begetting selling. When you look at the column on the far right, showing the cumulative net flows out, you can see (at least in our opinion) why we think there is an attractive opportunity in credit, as shown by the table above.

Investors Have Been Leaving Equities and Fixed Income for Money Markets

Category Flows in 2020

Monthly for January, weekly afterward

	Jan-20	02/05/20	02/12/20	2/19/2020 (S&P 500 Index Peak)	02/26/20	03/04/20	03/11/20	03/18/20	03/25/20	Cumulative Net Flows Since Index Peak
Domestic Equities	–\$24.5	\$5.9	\$4.4	–\$3.3	–\$13.5	–\$17.3	\$17.6	–\$6.4	–\$30.2	–\$49.8
World Equities	\$16.6	\$7.0	\$3.2	\$3.5	-\$0.4	–\$3.0	-\$1.6	–\$5.2	–\$10.6	–\$20.7
Total Equities	–\$7.9	\$12.9	\$7.6	\$0.3	–\$13.9	–\$20.2	\$16.0	–\$11.6	–\$40.8	–\$70.5
Taxable Bonds	\$60.0	\$10.7	\$15.9	\$12.2	\$0.2	–\$17.2	–\$29.2	–\$94.0	–\$80.7	–\$221.0
Municipal Bonds	\$13.9	\$3.0	\$3.3	\$2.6	\$3.0	–\$0.5	–\$3.1	–\$20.4	–\$20.1	–\$41.0
Total Bonds	\$73.9	\$13.7	\$19.1	\$14.9	\$3.2	–\$17.8	–\$32.3	–\$114.4	–\$100.8	–\$262.1
Commodities	\$2.6	\$0.8	\$0.5	\$0.8	\$0.2	\$0.3	\$2.3	–\$1.5	\$2.8	\$4.2

Source: Investment Company Institute.

Notes: Weekly fund flows are estimates based on reporting covering more than 98% of mutual funds and ETF assets, while actual monthly mutual fund net new cash flow and ETF net issuance data are collected and reported separately. Past performance is not indicative of future results.

From the table below, one can see "there was no place to hide" during this sell off. The only asset that was non correlated was short and long term U.S.Treasuries. We think going forward; interest rates will continue to stay very low.

Most Stocks Declined Significantly During the Recent Down Market…

Performance of U.S. Stocks in the Russell 3000 Index from Peak to Trough

(2/19/20 – 3/23/20)

Period Return	Number of Stocks	% of Stocks	GICS Sector	Average Stock Performance	Median Stock Performance
>0%	65	2.2%	Energy	–56.1%	–58.6%
0% to –10%	69	2.3%	Consumer Discretionary	–49.0%	–51.8%
–10% to –20%	181	6.1%	Real Estate	–46.8%	–47.0%
–20% to –30%	394	13.2%	Financials	–43.2%	–42.8%
–30% to –40%	714	23.9%	Industrials	–42.9%	–42.2%
–40% to –50%	696	23.3%	Materials	–40.9%	–40.3%
–50% to –60%	448	15.0%	Communication Services	–39.2%	–39.2%
–60% to –70%	267	8.9%	Information Technology	–35.7%	–36.2%
–70% to –80%	112	3.8%	Health Care	–32.4%	–34.4%
<–80%	39	1.3%	Utilities	–31.9%	–33.5%
			Consumer Staples	–23.7%	–26.5%
			Russell 3000 Index	**–40.52%**	**–40.89%**

…and Volumes Nearly Doubled

Change in the Average Daily Volume After the Market Peak, by Sector

GICS Sector	Change in Average Daily Volume (12/31–2/19 vs. 2/20–3/31)
Financials	133%
Real Estate	108%
Energy	103%
Industrials	102%
Consumer Discretionary	100%
Utilities	77%
Information Technology	76%
Consumer Staples	75%
Health Care	70%
Communication Services	65%
Materials	54%
Russell 3000 Index	**90%**

Source: FactSet.

Notes: The Change in Average Daily Volume is calculated as the change in the average aggregate daily share volume within each GICS sector in the Russell 3000 Index. It is not possible to invest in an index. Past performance is not indicative of future results.

Fed Comments this week

The Federal Reserve (FED) finished their meetings yesterday, **and to the surprise of everyone, they announced nothing.** That in itself was significant as that told the markets the FED is prepared to fight through a longer recovery process.

What was expected was talk about an exit strategy similar to the ill-fated raising of interest rates in 2018/19 that lead to a significant selloff. Instead the FED signaled concern over the medium term with respect to the shutdown, and they would continue to keep rates down for a couple of years. Furthermore there was a comment of doing more, and no mention of their successful moves so far! The implications are very straightforward, lower for longer with more unconventional policies if needed.

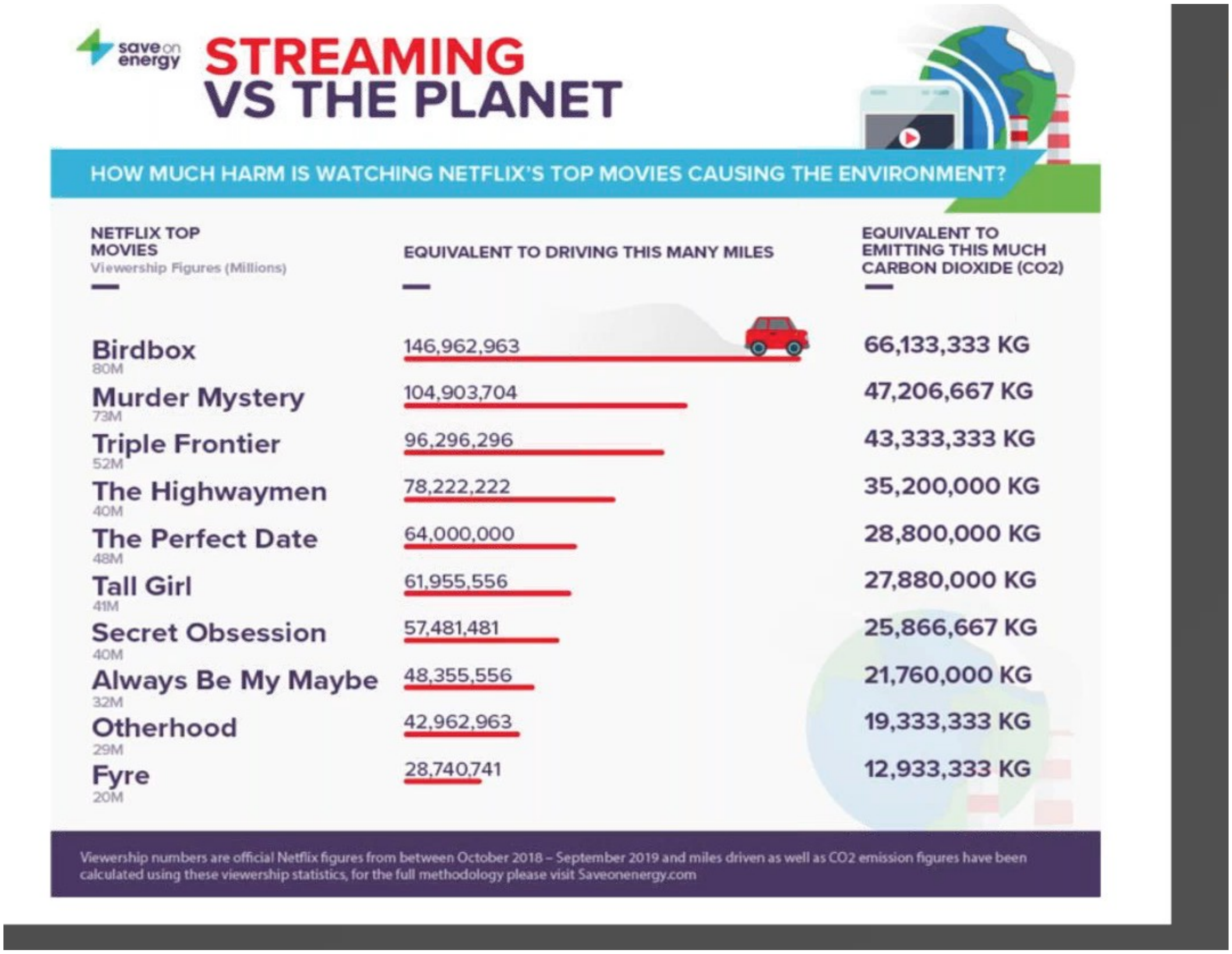
Retail Sales

Michael Gayed, CFA, whose Lead-Lag Report I have started following suggests people are thinking retail is dead, and physical store demand will go the way of the Dodo bird, due to Amazon and the like. While this is a transformative time for retail, it will survive, just witness the success of Walmart in on-line sales. Retail has been around forever, will make changes to survive, and survive they will. Furthermore he said the following, "They are adapting to the new environment by offering unique in-store experiences, managing their expenses better, driving down regulatory costs with tech solutions, and offering in-store and pick-up discounts not available through their online platform. And while the coronavirus pandemic is going to ripple through the industry and possibly take out some smaller players, many will survive and thrive in the new environment. People have been claiming death to retail for an exceptionally long time, and it has not happened."

Listening to a Conference Call on Utilities and Energy

The chart (below) just blew me away as it showed the energy usage from our clean industry of the internet! One large "server farm" requires the same amount of energy as 40,000 houses.

Staggering is the consumption of energy and CO2 emitted to the atmosphere. We will not have an efficient electric grid until we utilize nuclear fuel as an energy source, and develop better storage for renewable energy (technological breakthrough required).



Source: Saveonergy.com

How is COVID-19 doing in Tucson / Phoenix, and the rest of the U.S. The New York Times offers a great link below for you to look if so inclined.

https://www.nytimes.com/interactive/2020/04/03/upshot/coronavirus-metro-area-tracker.html?campaign_id=168&emc=edit_NN_p_20200427&instance_id=17973&nl=morning-briefing&regi_id=111544523&section=topNews&segment_id=26045&te=1&user_id=c965178178b4b33ffd40bc9656b5e9fe

Out of curiosity I looked at my calendar from March 1 through April 30, and I had scheduled in excess of 70 conference calls to try and get a handle of what was happening, and how to proceed. I now know how to work Zoom, a number of other video functions, occasionally doing in listen only mode several conference calls at the same time (not a good idea unless you know in advance which one you really want to listen to).

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:
Calafia Beach Pundit, Seeking Alpha April 17, 2020
Wall Street Journal April 23. 2020, When Oil Prices Went Negative, Investors in China Took a Hit
Stan Sokolowski Catalyst Insights April 13, 2020
Baron Shareholders letter, March 31, 2020
Avalon Investments & Advisory, “Fed Doesn’t Want to be A “L”oser April 30, 2020
Michael Gayed, CFA Lead Lag Report April 30, 2020
NY Times April 27. 2020 How Severe are Coronavirus Outbreaks across the U.S., Look up any Metro Area