May Outlook & Updates

I hope this note finds everyone well, safe and sane. It is hard to believe it is May already as the days in pandemic lock down increasingly blur together.
We wanted to take some time in this note to highlight performance over the past two months and dive into a few interesting tidbits collected over the past few weeks.

	Monthly Returns					
	S&P 500	US Treasury	US Agency	US Corporate	US High Yield	Municipal
April	12.68%	0.64%	0.51%	5.24%	4.51%	-1.26%
March	-12.51%	2.89%	0.98%	-7.09%	-11.46%	-3.63%

Source: Standard & Poor's & Bloomberg Index Services

Dismal risk-asset performance in March paved the way for a somewhat surprising rebound in April. Market participants, particularly in the equity market, are content to “look through” the current pandemic and scoop up stocks despite the unknowns. More shocking than the numbers above is the drawdown the S&P 500 experienced this year as the index fell 34% from the all-time high achieved on February 19th to the near-term low on March 23rd. The Treasury market largely treaded water in April while the municipal market continues to struggle given the confluence of fund outflows and difficulty assessing budget gaps and revenue hits given the rapid and severe nature of the impact on state and local government finances.

The Federal Reserve concluded their most recent monetary policy meeting on April 29th and left us with clear guidance that the central bank stands ready to do whatever it takes to help the economy and is in no hurry to raise rates. We cannot help but think we will be in this low-rate environment for some time. At April month end, federal fund futures confirm this message with no rate hikes priced in for the next 5 years and only one 25 basis point hike in the next 10 years. Let’s hope the market is wrong on this one.

Economic data continues to set records in the wrong direction and likely will continue the trend as we begin to see April data roll in. It is difficult to square the various corners of the market as stocks point toward an optimistic outcome while interest rate, inflation and credit markets point toward a more challenged path forward. In particular, I am watching inflation markets as they point toward a very low inflation world despite massive stimulus efforts out of the Fed and lawmakers on Capitol Hill.

Noteworthy items from the past few weeks:

- The thawing of credit markets paved the way for a record month of issuance as $292 billion of debt was issued in the U.S. investment grade credit market in April.

- The beleaguered Boeing Company issued $25 billion of debt on April 30th including $3.5 billion of debt maturing in 2060. The company’s 3-year debt was priced at 4.25% over the 3-year Treasury yield. The last time Boeing issued 3-year debt was on April 30th of 2019 at 0.52% over the 3-year Treasury yield.

- Do not blame the credit rebound and massive corporate debt issuance wave on the Fed. As of April 30th, they have not utilized their buying programs aimed at investment grade credit, securitized assets or short-term municipal securities. At this rate, will they even need to?

- New car sales fell precipitously as, according to Ward's Automotive Group, auto sales fell to an 8.58 million annualized rate which marks an all time low for the data series which was started in 1976. The auto market had been running at a stable annualized rate of approximately 17 million vehicles throughout the past 5 years.

- Ford Motor Company is now officially a high-yield company and a large one with over $104 billion in debt outstanding. Ford tapped the credit market in April, along with seemingly everyone else, as they raised $8 billion with yields north of 8.5%.

- Staying in the automotive space, the shutdown in auto auctions and auto lots created a void in the market for cars coming off lease and leaving fleets. This sent used car prices plunging a record 12.75% in April according to the widely followed Manheim Auction used car price index. This, combined with the state of the travel industry, puts the viability of car rental companies in serious jeopardy. It may be a tie right now as to the worst industry to be in – cruise lines or car rental companies. Both are likely to need major transformations.

- The Transportation Security Administration (TSA) began reporting traveler throughput and the results are stunning. As of April 30th, the TSA is reporting traveler levels that are 94% lower than one year ago.

- Keeping to travel, Duane Pfennigwerth, an analyst from Evercore ISI, placed a $1 price target on American Airlines and had the following quote after the firm's earnings call – "Parts of American's earnings call yesterday struck us as out of sync with the severity of this crisis, such as the unwillingness to put a long-term network restructuring on the table. Equity investors may not be the target audience for these earnings calls anymore."

- Warren Buffet reported this weekend that he sold all his holdings in airline companies. His firm, Berkshire, had held approximately $6 billion in American Airlines, Delta, Southwest and United. Mr. Buffet was quoted on a webcast as saying, "I don't know that three, four years from now people will fly as many passenger miles as they did last year, you've got too many planes."

- Ben van Beurden, the CEO of Royal Dutch Shell stated that "We do not expect a recovery of oil prices or demand for our products in the medium term." He later added "That means we probably have to re-establish what is going to be our strategy." Keep in mind this is the same CEO and firm that spent $70 billion to purchase British Gas just 5 years ago.

- ExxonMobil posted its first quarterly loss in nearly 32 years as the firm took a $2.9 billion write down on the value of their energy assets. In contrast to the tone out of Royal Dutch Shell, Exxon believes long-term fundamentals for energy demand remain strong.

- James Gorman, CEO of Morgan Stanley, made headlines in an interview after reporting most of the firm's 80,000 employees were working from home and that the results were outstanding. The CEO noted that Morgan Stanley's future involves "much less real estate". Having graced their Times Square offices several times myself, I am guessing this will save the company a significant amount of money. This begs the question of the future of trophy office buildings or office buildings at all. Time will tell.

- Not to be outdone by the Fed, the European Central Bank announced a fresh program aimed to boost lending in the eurozone. The name and acronym is a mouthful – Pandemic Emergency Longer-term Refinancing Operations – "PELTROS". In a nutshell, the ECB will lend money to banks at a -1.00% rate to make qualifying loans into the economy

- The United States Treasury has issued $1.56 trillion in new debt in the last two months. The pace of new issuance is not expected to slow anytime soon. Monday May 4th will see the issuance of the Treasury's updated refunding announcement. We expect to see fresh details on a new 20-year bond, discussion of SOFR floating-rate notes and details on how the Treasury expects to fund needs out of Washington. This otherwise dry announcement may prove interesting given the backdrop

- U.S. retails sales for March plunged 8.7%, the largest drop on record with data going back to 1967. Spending at grocery stores surged 26.9% while sales at restaurants and bars declined 26.5%. Sales at clothing stores plunged 50.5%. I think the demise of the mall may come at the hands of COVID-19 rather than Amazon. The next reading is set for release on May 15th, I am anxious to see the details.
- American Express and Discover Financial released their earnings and noted to eye-popping changes in spending. Discover reported a 99% decline in travel spending and 60% declines in both gas stations and restaurant spending for the month of April. American Express reported a 40% decline in spending with a 90% decline in travel and entertainment. The backdrop has changed so dramatically, card issuers are quickly rolling out benefits away from the travel industry in order to retain customers in their high-fee card offerings.