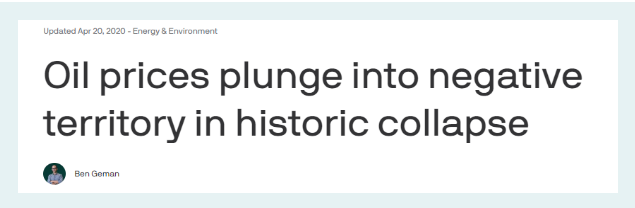
Brinker Capital

WEEKLY WIRE | APRIL 27, 2020

How can oil be worth less than nothing?



Updated Apr 20, 2020 - Energy & Environment

Oil prices plunge into negative territory in historic collapse

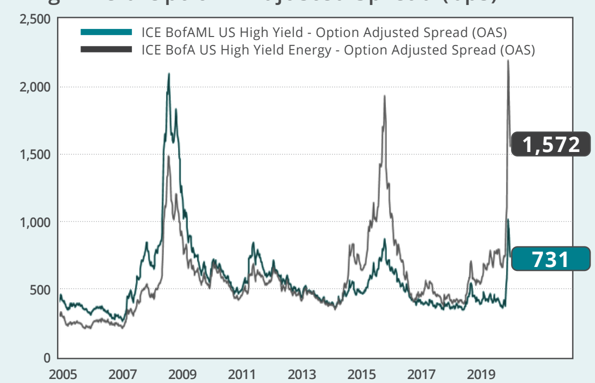
Ben Geman

They say if you live long enough you really do see everything. Well, last week investors saw something they had never seen before - the price of a barrel of oil going for negative $37, at least based on the May 2020 futures contract on West Texas Intermediate (WTI). A development which begs the question - how can oil be worth less than nothing? The short answer is it isn't. So, we shouldn't be on the lookout for gasoline prices going to zero, or lower - though it would be nice if we were paid at the pump. The long answer speaks to the peculiarities of the futures market. Before we go down that road, let's take a quick 10,000 foot view of the energy market.

Coming into 2020 the world was producing about 101 million barrels of oil a day, roughly in-line with global demand, and WTI was trading for about $60 a barrel. The demand for oil began to weaken as China locked down its economy to contain COVID-19. Then the demand plunged as OPEC+ couldn't agree on production cuts and other nations shut down their economies in response to COVID-19. Now, the International Energy Agency predicts global demand for oil will drop by 29 million barrels a day in April and by 9.3 million barrels a day for all of 2020. Beyond that, the world is quickly running out of room to store the oil it continues to produce but can't use.

This brings us to April 20 and the May contract on WTI which would expire on April 21. As the trading day went on, it became evident holders of contracts who had intended to take possession of the associated commodity no longer had the interest or ability to do so. The contract traded down to and then below zero, a development that was driven by the pending expiration of the contract as much as anything else. Now that said, the outlook for oil remains challenged as the outlook for the economy remains challenged. A 10 million barrel a day production cut is coming online May 1, the US rig count is plunging, and we are beginning to see countries and states start to reopen their economies, all of which should help support the price of oil. The June 2020 WTI futures contract is trading at $17, incredibly depressed to be sure, but well removed from negative $37. Finally, we would point out that while high-yield energy bonds continue to trade at very distressed levels, they are well off their recent lows.

High Yield Option - Adjusted Spread (bps)



Stocks, bonds, and commodities (4/24/2020)

Security name	Last	QTD chg	YTD chg	12mo chg
S&P 500	2836.74	9.76%	-12.20%	-3.09%
MSCI AC World ex USA	235.96	2.73%	-21.78%	-17.58%
MSCI EAFE	1588.69	1.87%	-22.01%	-17.14%
MSCI EM	879.41	3.63%	-21.11%	-18.91%
Bloomberg Barclays US Agg	--	--	--	--
Crude Oil WTI	17.18	-16.11%	-71.86%	-73.93%
Natural Gas	1.87	14.27%	-14.39%	-25.04%

Treasury rates (4/24/2020)

	Price	Yield
2Y	100.092 / 100.0	0.221
3Y	99.296 / 99.30	0.271
5Y	100.190 / 100.1	0.377
7Y	100.224 / 100.2	0.520
10Y	108.160 / 108.1	0.604
30Y	120.206 / 120.2	1.176

Weekly reports

This week
- GDP Q1
- Chicago PMI

Last week
- Initial Claims 4,427K
- PMI Composite 27.4

Brinker Capital Market Barometer

APRIL 2020

The COVID-19 pandemic remains a weight on the economy, financial markets, and confidence. We continue to view this crisis as more of a temporary disruption to the economy, where a coordinated healthcare response and a powerful policy response—both fiscal and monetary—is needed to bridge the gap. The Federal Reserve (Fed) has swiftly gone all-in on promoting liquidity and market functioning, and we can expect easy monetary policy for the foreseeable future. Congress followed through last week with a $2 trillion fiscal package that provides support to individuals and businesses until we can reopen the economy again.

SHORT-TERM FACTORS (< 6 months)

	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Momentum		●			Markets have bounced off bottom but momentum still weak
Trend		●			Trend remains weak despite recent bounce; likely retest of lows
Investor sentiment				●	Extreme pessimism levels with bears outnumbering bulls; equity fund outflows
Seasonality			●		Seasonality neutral in second quarter

INTERMEDIATE-TERM FACTORS (6-36 months)

	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Fiscal policy	→			●	Strong response but unclear on speed of implementation and if more is needed
Monetary policy				●	Fed all-in to support markets and economy; Global central banks taking action
Inflation				●	Global inflation low and inflation expectations muted
Interest rate environment	→		●		Treasury yields remain at low levels; yield curve has normalized
Macroeconomic		●			Significant growth decline in 2Q due to measures taken to prevent the spread
Business sentiment		●			CEO confidence likely to remain weak due to virus and election uncertainty
Consumer sentiment			●		Virus has started to have a negative impact on consumer confidence
Corporate earnings		●			Global revenues and earnings will be negatively impacted by COVID-19 in 2020
Credit environment			●		Credit environment challenging but Fed has implemented support measures

LONG-TERM FACTORS (36+ months)

	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Valuation				●	Equity valuations attractive relative to long-term averages
Business cycle		●			US recession now the base case given disruptions caused by COVID-19
Demographics			●		Mixed - US and emerging markets positive but developed international negative

Source: Brinker Capital. Information is accurate as of March 30, 2020. Themes and specific funds utilized to implement themes are discussed within the context of Brinker Capital's managed asset allocations and are based on current market conditions and constitute Brinker Capital's judgment and opinions, which are subject to change without notice. Past performance does not guarantee future results. Statements referring to future actions or events, such as the future financial performance of certain asset classes or market segments, are based on the current expectations and projections about future events provided by various sources, including Brinker Capital's Investment Management Group. These statements are not guarantees of future performance and actual events may differ materially from those discussed. Brinker Capital Inc., a registered investment advisor. MSCI AC World ex US Growth: An index made up of approximately the top 50% of the MSCI AC World ex US Index as composite ranked by five growth rates. This is a common proxy used to represent the growth segment of the developed international market. MSCI EAFE Index: A market-capitalized weighted index representing developed international equity markets located in Europe, Australia, Asia and Far East (EAFE). S&P 500 Index: An index consisting of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large-cap universe. Companies included in the Index are selected by the S&P Index Committee, a team of analysts and economists at Standard & Poor's. Barclays US Aggregate Index: A market capitalization-weighed index, maintained by Barclays Capital, and is often used to represent investment grade bonds being traded in the US. MSCI Emerging Markets: a float-adjusted market capitalization index representing 13% of global market capitalization. Captures mid and large cap across more than two dozen emerging market countries.