Market Volatility: An Update on COVID-19 and Oil

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The past week has seen a further increase in volatility in the markets, primarily due to the COVID-19 concerns. Since the U.S. equity market peaked on February 19th, the S&P 500 has moved more than 3% in a day eight of the thirteen trading sessions. As of mid-morning today we are experiencing the largest daily single downturn, on the order of 8%.

Today's price action is a reminder that even in the midst of one crisis, drawing most of investors' attention, other fundamental changes can take place. Last week, Russia refused to agree to oil production cuts proposed by OPEC, sending crude oil prices downward. Over the weekend, Saudi Arabia announced it would slash prices on its crude, thereby exacerbating this price war. Russia's original intention was to drive the largely unprofitable U.S. domestic oil producers out. Even though these domestic companies have been able to increase U.S. oil production by more than one million barrels a day, they have failed to be profitable. At $33.30 per barrel (the price as of this morning, Monday March 9th), none of these producers can flourish. This level is so low that even Russian companies fail the profitability test, leaving Saudi Arabia with some of the lowest "lifting costs" in the world as one of few areas able to produce profitably. Lower oil prices are a positive for the global economy as petroleum products represent a cost input for many manufactured goods. That, of course, is tempered by the fact that, due to COVID-19, production is already at low levels. More critically, powerful downward moves in oil prices can cause major geopolitical disruptions. This will be a central focus for us.

From a broader macroeconomic perspective, we have few data points that inform us as to how consumers and producers are faring after the flare-up in COVID-19 on February 19th. The likelihood of recessions in the U.S., Europe and Japan have increased. We anticipate downward pressure on earnings with optimistic readings pointing to no earnings growth for the U.S. in 2020. Assuming that, today's stock prices continue to appear a bit overvalued (but not terribly so).

As previously described, our stance remains cautious but cognizant that markets can easily overreact to events such as these. Though there will likely be opportunities to capture some of these mis-pricings, we don't feel we have yet reached that point.

Prudent asset allocation strategies have proved their value in this environment. With interest rates heading to all-time lows, bonds have appreciated dramatically this year, providing critical ballast to portfolios.

Our research and client teams are, as ever, focused on balancing risks and opportunities, mindful of short-term disruptions, but focused on the long-term. We are here should you have any questions and we will keep you updated as circumstances change.