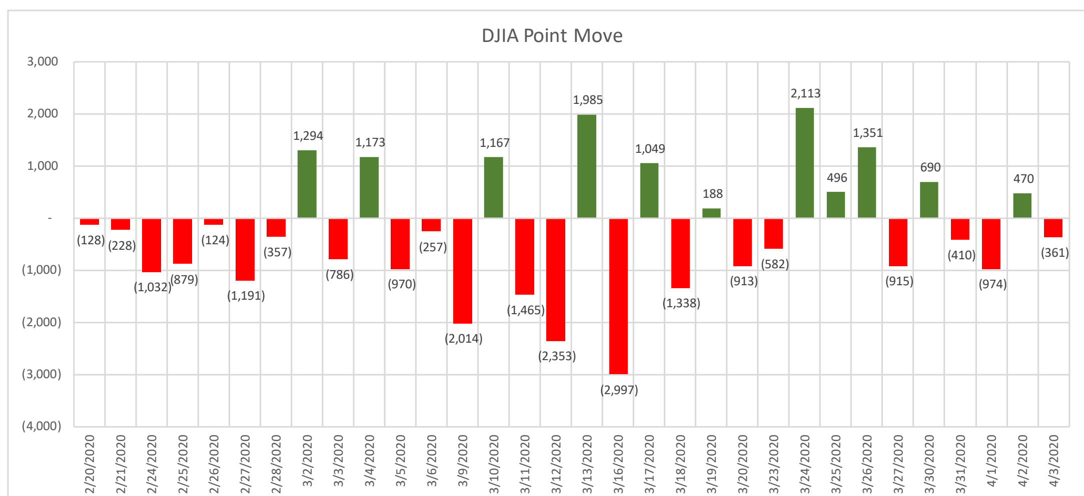
VANDERBILT Ave.
ASSET MANAGEMENT

1st Quarter 2020

We are in an unprecedented time due to the coronavirus and the toll it is taking from a human, economic and financial market perspective. Our hearts go out to all who have been affected either directly or indirectly by the virus. In order to fine tune our economic outlook, we will need more clarity with regards to both the duration and depth of the virus. In general, the economic pattern in the near-term includes a significant decline in GDP during the second and perhaps the third quarter.

Once the virus starts to abate and there is the beginning of normalization to economic activity, we should see some pent-up consumer demand (70% of overall GDP). In this article, we want to share some thoughts on the coronavirus and outline what is occurring in the oil market and potential ramifications.

The **coronavirus** pandemic has become a driving factor of market volatility and the degree to which this virus subsides and becomes negligible is yet an unknown. With over 1 million confirmed cases and 55,000 reported deaths globally (as of April 3rd), the expectation is that the numbers are likely to rise. The virus is highly communicable and can be spread without any visible symptoms. Trying to pick a top or bottom in a market environment such as this is foolhardy.



Net Point Loss from February 20 to April 3: -8,296 (-28%)

We are experiencing large swings in the financial markets during the coronavirus pandemic.

* The largest point drop in history occurred on March 16, 2020, dropping the Dow Jones Industrial Average 2,997 points.

* The largest point gain (+2,113) occurred on March 24, 2020

Largest daily point gains

Rank	Date	Close	Pt Change	% Change
1	3/24/2020	20,704.91	2,112.98	11.36
2	3/13/2020	23,185.62	1,985.00	9.36
3	3/2/2020	26,703.32	1,293.96	5.09
4	3/4/2020	27,090.86	1,173.45	4.53
5	3/10/2020	25,018.16	1,167.14	4.89
6	3/26/2020	22,552.00	1,351.00	6.37
7	12/26/2018	22,878.45	1,086.25	4.98
8	3/17/2020	21,237.38	1,048.86	5.2
9	10/13/2008	9,387.61	936.42	11.08
10	10/28/2008	9,065.12	889.35	10.88

Largest daily point losses

Rank	Date	Close	Pt Change	% Change
1	3/16/2020	20,188.52	-2,997.10	-12.93
2	3/12/2020	21,200.62	-2,352.60	-9.99
3	3/9/2020	23,851.02	-2,013.76	-7.79
4	3/11/2020	23,553.22	-1,464.94	-5.86
5	3/18/2020	19,898.92	-1,338.46	-6.3
6	2/27/2020	25,766.64	-1,190.95	-4.42
7	2/5/2018	24,345.75	-1,175.21	-4.6
8	2/8/2018	23,860.46	-1,032.89	-4.15
9	2/24/2020	27,960.80	-1,031.61	-3.56
10	4/1/2020	20,943.00	973.65	-4.44

The key to understanding the impact of the virus on economic activity is tied to the duration of the infection rate, as well as its breadth. Preparedness and rapid response will be key towards combating the spread of the coronavirus. Global economic activity returning to some sort of economic normalcy will likely be gradual. But please keep in mind, pandemics do come to an end.

Oil prices for the past twelve months, prior to the OPEC+ meeting in Vienna in early March, traded within a range of $44 to $63 per barrel. OPEC+ debated how to slash oil output to offset the collapse in demand due to the coronavirus outbreak. While past oil shocks have been driven by either supply or demand, the price collapse of 2020 is highly unusual in oil market history. It resulted from a significant drop in demand coupled with large inventory supplies at the same time. As the extent of the demand drop became clear, Saudi Arabia pushed the other OPEC+ countries to agree to the steepest supply cuts in more than a decade. Russia had made clear its' resistance to cutting supply given concerns about whether cuts would be effective. Russia was also reluctant to throw a lifeline to U.S. shale oil producers struggling under low prices and high debt. After hours of fruitless negotiations, ministers left Vienna without a deal, an oil price war ensued, and oil prices cratered. WTI crude oil traded below $20, near an 18-year low, but has rebounded somewhat and closed at $28.34 per barrel on April 3rd.

The collapse of Saudi-Russian cooperation, and the ensuing price war, will have significant implications. Firstly, Saudi Arabia's decision to tank the oil market is a big risk if it intends to bring Russia back to the negotiating table. The problem for the Kingdom is that while their production costs are lower than Russia, their fiscal break evens are higher than the Kremlin. Thus, Russia is more resilient to lower prices, having added considerably to its foreign exchange reserves at a time when Saudi Arabia's fiscal cushion has dwindled. Secondly, the collapse of the OPEC+ production agreement in Vienna risks long-lasting damage to the cartel. In recent years, OPEC+ had already been challenged by the surge of shale oil output and a decline in OPEC+'s market share. Yet, allowing a non-member of OPEC to scuttle a deal, to which all OPEC countries had agreed, is a blow to the cartel's credibility. Thirdly, the biggest loser in the Saudi-Russian disagreement may well end up being the U.S. shale oil industry. Many shale producers have hedged their production, but if the current U.S. benchmark oil price remains around $25-$30 per barrel for an extended period, there will be widespread bankruptcies. Forecasts are estimating U.S. oil output will fall by more than 1 million barrels per day by next year if prices remain where they are today.

As we go to press, the United States is attempting to broker an agreement between Saudi Arabia and Russia to reduce production and arrest the precipitous decline in crude prices. On April 2nd, Saudi Arabia called for an emergency meeting of OPEC+ countries that is tentatively scheduled for April 9th. Saudi Arabia will attempt to establish production cuts that will be acceptable to oil producing countries. We are closely monitoring these developments as they unfold in what has become a very dynamic and fluid set of circumstances.

There are several crucial aspects to keep in mind with regards to the current uncertainty and volatility of the financial markets. Already there has been unprecedented fiscal and monetary policy stimulus to protect the economy and improve the liquidity and solvency in the financial system. Actions taken to date are intended to provide financial support to businesses and households and are meant to offset the impact of COVID-19 shutdowns. It is likely more programs will be enacted in the coming weeks. The fiscal stimulus of approximately $2 trillion will provide funds to individuals through direct cash payments, as well as target workers who have lost jobs due to steps taken to combat the virus. In addition, cash loans and grants will be made to companies (including the small business sector) in order to permit them to stay open and retain employees who otherwise would be discharged. Furthermore, large companies will receive government support to financially bridge the time period until the economy begins to normalize. The $2 trillion fiscal relief program will represent almost 9% of American GDP. This is larger than the rise in the federal government deficit introduced in 2008/2009.

The Federal Reserve will finance the fiscal stimulus program by buying financial assets to ensure that liquidity is available to market participants. The Federal Reserve balance sheet will balloon over the short run by an estimated $2-3 trillion - quantitative easing on steroids. Their actions have proven that anyone thinking the Fed had no degrees of freedom was wrong. Since the beginning of the year, the Federal Reserve has cut the federal funds rate from a 1.50-1.75% range to 0.0%-0.25% as of March 15th. They have also reinstated the multiple asset purchasing programs created during the 2008-2009 recession. In fact, new initiatives have been added to their arsenal to enhance market liquidity. Three of these new programs, which target businesses, are the

Primary Market Corporate Credit Facility, Secondary Market Credit Facility and the Main Street Business Lending Program. These programs are intended to improve access to credit for corporations and small businesses and improve liquidity for investment grade corporate debt. It is likely that most of the rise in public debt will end up on the Fed's balance sheet for a long period of time. The good news is that this combination of fiscal and monetary stimulus will eventually result in a pick-up of economic activity. The only reason this form of financing could be problematic is that inflation could rear its head. However, as we discovered in the financial crash of 2008, an increase in the monetary base, ceteris paribus, does not necessarily lead to an increase in inflation. The US economy is fortunate that inflationary expectations are running below the Fed's target and that lower oil prices will hold inflation down. These factors give a great deal of leeway to the fiscal and monetary stimulus programs.

Social-distancing patterns, as well as government-initiated quarantines, will severely affect economic performance. Industries that will feel an immediate impact include aviation, hotel, restaurant, cruise, shipping industries and the retail sector. The impact on tourism alone could be a significant blow to the economy. This industry represents close to 9% of U.S. economic output, $1.87 trillion of GDP, eight million jobs and 11% of exports. There is no question that the fiscal and monetary programs are intended to revive the consumer sector. For consumer confidence to recover, the coronavirus curve must bend. In addition, capital spending tends to follow earnings with at least a six-month lag. So, the initial hit to profits may hamper growth until the end of the year.

One of the saving graces during this difficult period is to keep in mind the benefits of diversification across asset classes. Specifically, your allocation to fixed income securities provided positive returns while equities provided negative returns and extreme volatility during these turbulent times.

Long Run Cross Correlations (1997-2019)

	Short Duration Fixed Income	Small Cap Equities	Large Cap Equities	Hedge Funds	REITs	Bank Loans	MLPs
Short Duration Fixed Income	100%						
Small Cap Equities	-18%	100%					
Large Cap Equities	-15%	83%	100%				
Hedge Funds	4%	63%	60%	100%			
REITs	4%	63%	58%	37%	100%		
Bank Loans	-10%	46%	44%	49%	49%	100%	
MLPs	6%	41%	42%	38%	34%	46%	100%

- The weak to negative correlation of Short Duration Fixed Income has played a distinguishing role during this crisis.

This pandemic and its consequences will ultimately end. The uncertainty regarding the duration and depth of the human and economic toll will continue to cause volatile financial markets for a while. We are, however, starting to see some positive developments. China is reporting fewer and fewer new cases in the last several days and is gradually starting up its economy and Germany's, as well as Italy's, growth rate of new cases appears to be slowing down. Massive monetary and fiscal stimulus in the U.S. will look to preserve the productive capacity of the country and the welfare of workers. Your portfolio's diversification and investment in short duration bonds has provided significant benefits.

On behalf of everyone at Vanderbilt Avenue Asset Management, I want to extend a sincere thank you to our clients for the trust they have put in us during these challenging times. We are fully cognizant that during periods like this we must earn the right to continue to serve you. Better days are ahead and please stay healthy and safe.