PALLAS
CAPITAL ADVISORS

Week in Review

Friday, May 1st 2020

- GILEAD issued a news release indicating the results from the NIAID trial on its experimental drug, Remdesivir, helped patients recover more quickly than with placebo treatments. This suggests it could become the first effective treatment for the illness caused by COVID-19. The trial enrolled more than 1,000 patients internationally and showed that patients who received the drug recovered in an average of 11 days, while those who received a placebo recovered in 15 days. Gilead shares jumped as much as 8.1% Wednesday after the company's statement.

- CRUDE OIL PRICES recovered from last week's low after a report from the American Petroleum Institute showed a smaller-than-expected U.S. crude inventory build. The API data showed U.S. crude inventories rising by nearly 10M barrels in the week of April 24, below the prior week's 13.2M barrel build and slightly less than the 10.6M barrels projected by analysts. Russian Energy Minister Alexander Novak reportedly said the country's oil output could fall by up to 15% this year, which would mark its first annual decline since 2008. Goldman Sachs highlighted several reasons why it is more positive on energy stocks, saying demand appears to be near a trough, shut-in announcements are increasing, and valuation is near 25-year lows on EV/gross cash invested.

- THE U.S. ECONOMY DECLINED at its fastest pace since the last recession throughout the first quarter of 2020, as the coronavirus pandemic shut down large parts of the country. GDP contracted at a seasonally and inflation adjusted annual rate of 4.8% in the first three months, the Commerce Department said this week. The downturn likely marks the beginning of a recession, economists say, and is the biggest drop in quarterly economic output since the fourth quarter of 2008. Data company IHS Markit expects GDP to decline at a 37% annual rate from April to June, which would represent the biggest drop since quarterly records began in 1947.

- AFTER WEEKS OF CLOSURES IN THE U.S., states from Mississippi to Tennessee to Colorado began to permit some businesses to reopen early this week, welcoming customers back and letting some employees return to work. Over the weekend, some businesses had resumed in Georgia, Oklahoma, Alaska, Texas and South Carolina. Retail stores, restaurants, malls, movie theaters, museums and libraries in Texas will be allowed to open Friday at 25% capacity. Many are watching the state's phased reopening as a test. The country's second most populous state has relatively low rates of Covid-19, but among the lowest testing rates, leading critics to say there is no way to know how prevalent the virus really is.

- ON THURSDAY, THE EUROPEAN CENTRAL BANK ACTED AGAIN, announcing a new series of long-term loans for banks and cutting the rate on its existing program as the euro-area economy plunged into a record contraction. Output in the 19-country region shrank 3.8%, reflecting shutdowns to contain the coronavirus that have pushed businesses close to collapse, sent unemployment surging. Italy, saddled with one of the world's highest debt burdens, saw GDP fall 4.7% in the quarter. France and Spain, also with limited room to spend their way out of the pandemic crisis, reported contractions of more than 5%.

- THE EUROPEAN CENTRAL BANK saw bond purchase targets remain unchanged, sending Italian bond yields higher. Separate figures showed inflation in the euro zone slowed to just 0.4% in April, the weakest since 2016. That was largely driven by the collapse in oil prices, with energy costs plunging almost 10%.

- DOZENS OF COMPANIES HAVE SUSPENDED THEIR STOCK BUYBACKS. In mid-March, the eight largest U.S. banks said that they were all suspending share buybacks through the second quarter of the year. Other industries have recently followed suit. AT&T, Coca-Cola, Chipotle Mexican Grill, Eli Lilly, Merck, Intel, American Express, UPS, Caterpillar, Harley-Davidson, Starbucks, Mastercard, and Ford Motor are among the companies that have discussed suspending stock repurchases on their recent earnings calls.

- TESLA REPORTED a slight first-quarter profit, putting forth three consecutive quarters of positive earnings. Chief Executive Elon Musk highlighted uncertainty and risk ahead, citing the forced shutdown of businesses including its lone U.S. assembly plant. Profits this quarter were fueled by the sale of regulatory credits and strong demand for its Model 3 compact car, despite the idling of its factory outside San Francisco for about the last week of the quarter.

- PRESIDENT TRUMP signed an executive order Tuesday that compels slaughterhouses to remain open. Meat processing plants around the U.S. have shut down because of the coronavirus, but Trump said in the order that "such closures threaten the continued functioning of the national meat and poultry supply chain, undermining critical infrastructure during the national emergency." Labor Unions opposed the order. At least 20 workers in meat and food processing have died, and 5,000 meatpacking workers have either tested positive for the virus or were forced to self-quarantine, according to UFCW.

Thinking Ahead

This week has been a positive week within the markets, where broad equities were up >2% in the US, led by mid-cap and smallcap stocks, up >6% and >7% respectively. The global developed markets paced the US, and emerging markets were slightly better, each returning 2.5% and 3%. The performance of the DOW was +11% for the month, representing its best April performance since 1938. This strength was also shared by other asset classes, including a rebound within the energy space, despite historic losses reported by Exxon, the world's largest oil producer outside Saudi Aramco.

Largely, the recent rotation has been into value, smallcap, and higher risk stocks. None of this has been surprising given that past upturns subsequent to sharp declines are mostly led by stocks that have suffered the most. The steepness of the recovery in some of downtrodden has been perplexing to many investors and started to shift sentiment from depression-like expectations a few short weeks ago, to anticipation of recovery as early as the next two quarters.

In past summaries, we've attributed this recent recovery to the record levels of stimulus put forth by regulators and monetary policy makers. In other words, the recovery has been mainly attributed to multiples expansion. Price 'P' declines at a lower rate than earnings 'E'. However, in the past few weeks, P has been increasing despite lower E. In this case, the expansion is engendered by a declining risk premium created by interest spread tightening caused by the stimulus.

The FED has committed to additional programs without any clear bounds. However, we are watchful on how long this can be realistically sustained, while continuing to seek opportunities.

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We will continue to provide weekly market updates. In the meantime, you can access our thought leadership pieces on our Insights page and by following us on LinkedIn.

You can access a recording of all prior webinars here.