CION INVESTMENTS

GAUGING THE COVID-19 RECOVERY

With 48 states loosening stay-at-home restrictions or reopening non-essential businesses as of the first week of May, we are entering the next phase. Will "reopening" limit damage to the economy?

"Timeboxing" The Pandemic

A March report by McKinsey & Co. sums up the two primary needs for recovery: "We need to find ways to 'timebox' this event: we must think about how to suppress the virus and shorten the duration of the economic shock."[1]

The research response to the coronavirus has been unprecedented and global in scope – as of the end of April, the World Health Organization reports more than 14,700 research papers have already been written about the coronavirus. And while the road to a vaccine is usually long, in this case researchers and scientists have had a head start: they can build on previous research done for the SARS and MERS viruses[2].

The measures that are being taken in an attempt to save the economy by reopening may also be having an impact on the spread of the virus. The models that predict the course of the disease and its toll have recently been revised to include states reopening. The result is a more dire outcome, and one that would seem to indicate that a W- shaped recovery may be more likely, as hot spots emerge and necessitate additional shutdowns.

However, post-reopening, there's every reason to think that business owners, employees and customers will all continue to follow safety-first practices. In fact, in places that are beginning to reopen, we are starting to see some encouraging results as people extend the behaviors that are familiar from grocery, and other essential shopping, to newly opened stores and services providers. Widespread continued safety standards could reduce the spread of the virus and result in a Nike "swoosh" economic recovery – a slower, but smoother upward trajectory.

The Recovery in a Changed World

But whatever the eventual shape of the recovery might be, it's becoming clear that certain changes to our society may be permanent.

In 2018, less than 4% of the workforce reported working from home. Since March, it's more than 50%. And for workers in the top 20% of salaries, it goes up to 70%.[3] Employers are reporting that productivity has been steady or even increasing. And as they come to grips with the

potential need – and cost – to retrofit workspaces, adopting more widespread work-from-home policies seems to be the trend. Secondary effects, such as sudden ubiquitous Zoom meetings, a steep decline in business travel, and the uncertain future of the entire travel industry will impact how businesses operate.

That and other changes will, of course, alter the investing landscape in ways that aren't easy to foresee. While commercial aerospace, travel, entertainment, and retail are all sectors that have been hit hard in the initial phases, the changes that will be wrought by our adjusting to the new normal have yet to be seen.

Markets Have Begun to Recover – And Despite Uncertainty, There Are Positive Factors at Play

Companies are increasingly suspending earnings guidance, and financial data company FactSet has determined that with just over half of S&P 500 companies reporting, earnings growth is down 13.7% in the first quarter. This would mark the biggest decline since the 3rd quarter of 2009. But despite this, the equity markets have somewhat recovered, and the factors presumed to be largely responsible for the performance gains are still in place. A stimulus package has been implemented in record time, and future monetary and fiscal stimulus is already underway. Additionally, consumer spending can potentially bounce sharply back as people venture outside their houses and give full rein to pent-up demand.

The credit markets have been effectively backstopped by the Federal Reserve and for the month of April all sectors except municipals turned in positive performance – but some, like high yield, are still underwater YTD. High single digit defaults in the liquid credit markets seem likely, but, based on the structure of the credits, the peak isn't expected to come this year. Because of the lack of covenants in today's loan market, defaults won't be triggered until payments aren't made.

Of course, there are industries that will be hit harder and where defaults will be higher. Liquid credit markets – both bonds and loans – may continue to experience heightened volatility, but there is potential value in defensive and well-capitalized credits. Because the sell-off was indiscriminate, there are also names that are trading below their intrinsic value, creating good entry points. In private credit markets, potential opportunities are focused on intensively researched cash-generating opportunities, such as forced asset sales and rescue financings.

The takeaway? Navigating these markets will eventually be possible. Patience, research, and flexible capital may again win the day, as they did in 2008-2009.

1 McKinsey & Co. Safeguarding Our Lives and Our Livelihoods. March 23 2020.

2 Nazario, Brunilda, MD. COVID-19 Vaccine. WebMD. May 13, 2020.

3 Pandey, Erica. The New Working World. Axios. May 5, 2020.

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