



MORNING BRIEFING

March 19, 2020

Collateral Damage from the War Against the Virus

Check out the accompanying [chart collection](#).

(1) COVID-19 ripple effects and plummeting oil prices slam Financials. (2) Life insurers hurt by low rates, falling investments, and fears of higher mortality. (3) Crash in oil hurts some regional banks. (4) Large banks' stock buybacks on hold. (5) Companies hit hardest draw on revolvers. (6) Market correction makes investment banking business uncertain. (7) Travel industry needs a vacation. (8) Cruise lines, airlines, and hotels all visit the White House. (9) A deal with Uncle Sam may mean dilution for shareholders.

Financials Sector: Flattened. The anticipated broad economic shock of COVID-19 and the historic drop in oil prices are pummeling the S&P 500 Financials sector's stocks.

From the market's February 19 peak through Tuesday's close, the Financials sector has fallen by a third. Here's how all of the sectors have performed during that time period: Consumer Staples (-11.4%), Health Care (-16.7), Utilities (-18.2), Real Estate (-23.9), Communication Services (-23.9), Information Technology (-24.6), S&P 500 (-25.3), Materials (-27.7), Consumer Discretionary (-29.0), Industrials (-31.1), Financials (-32.7), and Energy (-49.0) ([table](#)).

Low interest rates and the potential increase in morbidity is hurting life insurance companies. Expected loan exposure to the oil industry is hurting regional banks. The stock market drop and a sharp slowdown in stock and bond underwriting and M&A have diversified banks and asset managers under pressure. Let's take a quick look at where each of them stands:

(1) *Worries about life insurers.* Among the hardest hit Financials industries since the February 19 market peak through Tuesday's close is the S&P 500 Life & Health Insurance industry, down 46.9% ([Fig. 1](#)). The life insurance industry is hurt as the value of its investment portfolio falls and as interest rates fall, eroding the potential return on future bond investments it makes. Low rates also hurt the insurance policies that give holders a minimum level of interest payment, a March 11 *WSJ* [article](#) reported.

The 10-year Treasury bond yield has fallen to 1.18%, leaving investment-grade corporate bond yields near recent lows even as spreads have widened ([Fig. 2](#), [Fig. 3](#), and [Fig. 4](#)).

In addition to low rates, life insurers may face an unexpected increase in death payouts during the pandemic, offset to some degree by the cessation of annuity payments to annuity holders who die. It's a necessary, though morbid, industry.

Analysts are still calling for the Life & Health Insurance industry to grow revenue by 1.7% this year and 2.7% in 2021 ([Fig. 5](#)). Earnings are expected to rise by 6.0% this year and 8.4% in 2021, which compares to the 10.1% and 8.6% estimates on January 1 ([Fig. 6](#)). Its forward P/E, at 5.5, is the lowest it has been since September 2011 ([Fig. 7](#)).

(2) *Banks slipping on crude.* The 56% ytd drop in the price of Brent crude oil has hurt the S&P 500 Regional Banks stock price index, which has fallen 41.4% since the S&P 500's February peak ([Fig. 8](#) and [Fig. 9](#)). Investors are concerned about banks' loan exposure to the energy patch, particularly small frackers, which are often junk-rated and pumping oil at a loss at today's prices.

US and Canadian banks have more than \$100 billion in loans outstanding to energy companies, a March 16 *WSJ* [article](#) reported. Larger banks appear to be diversified enough that the oil industry represents just 2% to 3% of their loan portfolios and an even smaller percentage of their overall diversified business. Certain regional banks, however, have more concentrated loan books and fewer other business lines to absorb the blow.

The above *WSJ* article quoted a Keefe, Bruyette & Woods analyst estimating that the oil crash could hurt regional bank earnings this year by an average of 15% to 60%. Energy loans make up 18% of BOK Financial's loan book. BOK is parent to Bank of Oklahoma. It makes up 11% of Cullen/Frost Bankers' loan book and 5% of the loan books of Texas Capital Bancshares, Zions Bancorp, Hancock Whitney, Comerica, and BBVA USA.

Analysts continue to expect the S&P 500 Regional Banks industry to grow revenues by 11.6% this year and 2.5% in 2021 ([Fig. 10](#)). Forecasts for the industry's earnings growth have fallen to 1.8% this year and 7.1% in 2021, down from 4.5% and 7.8% at the start of the year ([Fig. 11](#)). The Regional Banks' forward P/E has fallen to 7.7, down from 12.4 on January 1.

(3) *No escape for large banks, either.* While they may not have loaded up on energy loans, the large banks are also having a tough time. The S&P 500 Diversified Bank industry's stock price index has fallen 36.8% from the market's February peak through Tuesday's close ([Fig. 12](#)).

The country's largest banks announced on Sunday plans to halt stock buybacks so they could increase their lending during the COVID-19 outbreak. JPMorgan Chase, Bank of America, Citigroup, Wells Fargo, Goldman Sachs Group, Morgan Stanley, Bank of New York Mellon, and State Street won't make repurchases through June 30. While what they're doing is commendable, it does take away potential buying support from their respective stocks.

In addition, companies in distressed industries are drawing down their bank loan revolvers as they husband liquidity. On Wednesday, Boyd Gaming drew down the remainder of its revolving credit facility, \$660 million, after closing all its casinos in Iowa, Kansas, Missouri, and Nevada to comply with orders from the states' governments. Others that have drawn down their bank lines include Carnival, Penn National Gaming, and Boeing. Were that not enough, the sharp drop in the stock market typically results in assets under management falling and investment banking business drying up.

Revenue for the S&P 500 Diversified Banks is forecast to fall 2.0% this year and rise 2.2% next year ([Fig. 13](#)). Earnings are still slated to be almost flat this year, 0.3%, and up 8.5% in 2021, which compares to estimates of 3.7% and 8.3% at the start of this year ([Fig. 14](#)). The industry's forward P/E, at 7.8, has fallen from 11.9 at the year's start.

Travel Industry: Grounded. With everyone sheltering in place, flights from Europe and Asia banned, cruises docked, and governors closing casinos, the travel industry is under duress. The S&P 500 Hotels, Resorts & Cruise Lines stock price index has fallen by 57.5% from the market's February 19 peak through Tuesday's close. Not far behind is the 54.8% drop in the S&P 500 Casinos & Gaming industry and the S&P 500 Airlines industry's 45.3% decline ([Fig. 15](#), [Fig. 16](#), and [Fig. 17](#)). Here's Jackie's look at some of the latest developments in each of these hard-hit areas:

(1) *Shipwrecked.* As COVID-19 reached US shores, the cruise industry was the first to hit rough seas. Pictures of passengers, some infected with the disease, stranded on the Diamond Princess won't soon be forgotten. The largest cruise lines—including Carnival Cruise Lines, Norwegian Cruise Lines, and Royal Caribbean—have since docked their ships in the US until at least April 11.

But in reality, the suspensions may last longer. Spring cruises to Europe are unlikely, as the Centers for Disease Control and Prevention (CDC) has given Europe a Level 3 warning, asking US citizens to avoid nonessential travel there. Cruises to Alaska are doubtful with Canadian ports closed to ships with more than 500 people until July. Before the COVID-19 outbreak, 32 million passengers were expected to cruise in 2020, according to Cruise Lines International Association data quoted in a March 17 *NYT* [article](#).

This week, the hotel industry cried “Uncle!” (as in “Uncle Sam, help!”) as it started laying off employees and closing properties. US hotel occupancy levels, which were around 80% a few weeks ago, have fallen to 20% or lower. Marriott, which has about 130,000 employees in the US, expects “to furlough tens of thousands of employees as it ramps up hotel closings across the globe,” a March 17 *WSJ* [article](#) reported.

Analysts have been slashing their 2020 estimates for the S&P 500 Hotels, Resorts & Cruise Lines industry. Revenue is expected to grow 2.4% this year and 6.3% in 2021 (compared to estimates on January 1 of 5.7% and 6.0%) ([Fig. 18](#)). Earnings are forecast to fall 6.0% this year and bounce back to 17.2% growth in 2021 (compared to estimates on January 1 of 8.6% and 10.0%) ([Fig. 19](#)). The industry’s forward P/E of 9.8 has tumbled since it peaked at 19.6 in January 2018 ([Fig. 20](#)).

(2) *Vegas goes dark*. Meanwhile, slot machines have stopped ringing across the country as large gatherings in most states have been banned. On Monday, New Jersey’s governor called for the closure of Atlantic City’s casinos, and the following day Nevada’s governor ordered casinos on the Las Vegas strip closed for a month.

Revenue and earnings growth forecasts have dropped sharply for the S&P 500 Casinos & Gaming industry. Revenue is forecast to fall 4.2% this year and jump 9.1% in 2021 (compared to analysts’ January 1 forecasts of 3.8% and 3.4%) ([Fig. 21](#)). Likewise, the industry’s earnings are forecast to tumble 6.3% this year and rebound by 38.2% in 2021 (compared to January 1 forecasts of 48.1% and 14.8%) ([Fig. 22](#)). The industry’s forward P/E has fallen to 17.1, down from 28.4 earlier this year ([Fig. 23](#)).

(3) *Hitting turbulence*. Not surprisingly, airlines have also started laying off employees and slashing capacity. Delta Air Lines cut international flights by roughly 25% and domestic flights by 10% to 15%. American Airlines will cut its summer international capacity by 10% and April

domestic capacity by 7.5%. United and JetBlue made cuts last week. The airlines employ almost 750,000 people, and they've been asking workers to take unpaid leave, a March 17 CNBC [article](#) noted.

Perhaps airline analysts are on vacation, but they're still expecting the industry to post revenue growth of 3.3% this year and 5.0% in 2021 (compared to their January 1 estimates of 4.7% and 4.9%) ([Fig. 24](#)). Even earnings are in positive territory, with analysts forecasting 0.9% earnings growth in 2020 and a 10.9% jump in 2021 (compared to January 1 estimates of 6.2% and 10.2%) ([Fig. 25](#)). The industry's forward P/E has fallen to 5.6, which is a bit different than in 2001 or 2008, when the industry's earnings fell and its forward P/E jumped into the 20s and above ([Fig. 26](#)).

(4) *A trip to the White House*. The travel industry met with President Trump to plead its case this week. "U.S. Travel Association CEO Roger Dow presented an analysis that projects decreased travel due to coronavirus could wipe out \$355 billion in total travel spending, including transportation, lodging, retail, attractions and restaurants. The economic pain, he argued, could be six times that of 9/11," another March 17 CNBC [article](#) reported.

The Bureau of Labor Statistics reports that the air transportation industry (including carriers of both passengers and cargo) employed [510,800](#) people in February, the accommodation industry (lodging) employed [2.1 million](#), and the amusement (e.g., amusement parks), gambling (casinos), and recreation (e.g., sporting arenas) industries employed [1.8 million](#) ([Fig. 27](#), [Fig. 28](#), and [Fig. 29](#)).

In a meeting with President Trump Tuesday, the travel industry requested \$150 billion in government aid. The industry requested a travel workforce stabilization fund, an emergency liquidity facility for travel businesses, and support to small businesses and their employees through the Small Business Administration, the CNBC article reported. Meanwhile, the airline industry is looking for \$50 billion of government assistance, including \$25 billion in direct grants, and Boeing has its hand out as well.

But not everyone is ready to sign a check. Senator Elizabeth Warren (D-MA) says she'll demand concessions from any big businesses getting federal aid, including an agreement to ban stock buybacks and maintain employee payroll. And Senator Richard Blumenthal (D-CT) recently tweeted "No blank check industry bailouts."

The Association of Flight Attendants wants to ensure that any government funds go to pay workers and provide benefits, not to pay CEOs bonuses, buy back stocks, or pay out dividends. Delta, American, Southwest, and United have spent about \$39 billion over the last five years repurchasing shares, according to S&P Dow Jones Indices.

Investors may want to wait to see the terms of any deal with Trump et al before jumping into these industries' stocks. The government could request equity in exchange for any payments, which could hurt shareholders. Share dilution fears might explain why on Tuesday, when the S&P 500 rallied 6.0%, several travel- and leisure-related S&P 500 industries saw their stock price indexes sink: Hotels, Resorts & Cruise Lines fell 10.1%, Airlines dropped 5.6%, and Casinos & Gaming lost 1.0%.

CALENDARS

US: **Thurs:** Leading Indicators 0.1%, Jobless Claims 219k, Philadelphia Fed Manufacturing Index 10.0, EIA Natural Gas Storage. **Fri:** Existing Home Sales 5.51mu, Baker-Hughes Rig Count. (DailyFX estimates)

Global: **Thurs:** China 1-Year & 5-Year Loan Prime Rates 3.95%/4.70%. **Fri:** BOE/TNS Inflation Next 12 Months. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators ([link](#)): The Bull/Bear Ratio (BBR) fell for the fourth week this week, though the seesaw movement between the bullish and correction camps (that went on for months and months) was replaced by a big swing between bearish sentiment and the correction count. The BBR sank to 1.06 this week—the lowest since the start of 2019—from 2.89 four weeks ago. Bearish sentiment jumped 9.8ppts (to 32.7% from 22.9%) this week and 13.8ppts the past four weeks—to its highest reading since the start of last year. Bearish sentiment had fluctuated in a very narrow band for most of 2019. The correction count sank 8.2ppts (32.7% from 40.9%) this week after jumping 14.5ppts the prior three weeks. Meanwhile, bullish sentiment fell for the fourth week, by 20.1ppts, from 54.7% to 34.6%—the lowest in more than a year. The AAll Ratio fell to 36.7% last week after climbing the prior week from 43.7% to 49.4%. Bullish sentiment fell from 38.7% to 29.7% last week, while bearish sentiment rose for the fourth week, from 26.4% to 51.3% over the period.

S&P 500 Earnings, Revenues, Valuation & Margins ([link](#)): Analysts are now reading the COVID-19 memo. Consensus S&P 500 forward revenues and earnings fell during the latest week after remaining steady since January near record highs. Forecasts for 2021 revenues and earnings are now falling too, and helping the forward estimates to decline. Forward earnings per share dropped 0.9% from its record high a week earlier, and forward revenues weakened to 0.5% below its record high in mid-February. Forward growth forecasts are now falling too. Analysts expect forward revenues growth of 4.3% and forward earnings growth of 7.6%. The revenues measure was down 0.3ppt w/w and earnings dropped 0.6ppt. Forward revenues growth is now the lowest since June 2016 and 2.0ppts below its seven-year high of 6.3% in February 2018. Forward earnings growth is down 9.2ppts from a six-year high of 16.9% in February 2018 but remains above its 34-month low of 5.9% in February 2019. Prior to the passage of the Tax Cuts and Jobs Act (TCJA), forward revenues growth was 5.5% and forward earnings growth was 11.1%. Annual growth expectations for 2020 are deteriorating rapidly. Analysts expect revenues growth of 3.9% in 2020 compared to the 4.3% reported in 2019. That's down 0.4ppt w/w and 1.0ppt since the start of the year. They're calling for earnings growth to improve to 5.5% in 2020 from 1.6% in 2019, but the 2020 growth rate tumbled 1.0ppt w/w and is down 3.4ppts since the beginning of the year. The forward profit margin dropped 0.1ppt to 11.9%, which matches the 22-month low of 11.9% in late December and is down 0.5ppt from a record high of 12.4% in September 2018. That compares to 11.1% prior to the passage of the TCJA in December 2017 and a 24-month low of 10.4% in March 2016. Analysts still expect the profit margin to improve 0.2ppt y/y to 11.7% in 2020 from 11.5% in 2019, but remain below the 11.8% recorded for 2018. Valuations have been extremely volatile on both a daily and weekly basis. For those following the weekly snapshot, the S&P 500's forward P/E fell 1.0ppt w/w to a 59-week low of 15.9, and is down from 19.1 in mid-February, which was the highest since May 2002. That's up from 14.3 during December 2018, which was the lowest reading since October 2013, and down 23% then from the 16-year high of 18.6 at the market's valuation peak in January 2018. The S&P 500 price-to-sales ratio fell 0.26pt to a 60-week low of 1.86, which compares to mid-February's record high of 2.29. That's up from 1.75 during December 2018, when it was the lowest since November 2016, and down 19% from its then-record high of 2.16 in January 2018.

S&P 500 Sectors Earnings, Revenues, Valuation & Margins ([link](#)): Consensus forward revenues fell w/w for all 11 sectors and forward earnings was down for all but Real Estate. Energy had both measures get crushed w/w. Forward revenues and earnings remain closest to record highs for 3/11 sectors: Consumer Discretionary, Health Care, and Tech. Forward P/S

and P/E ratios are down sharply for all sectors, and from recent record or cyclical highs for Communication Services, Consumer Discretionary, Information Technology, Real Estate, and Utilities. Due to the TCJA, the profit margin for 2018 was higher y/y for all sectors but Real Estate. Just five sectors (Consumer Staples, Financials, Industrials, Materials, and Tech) are expected to record higher margins y/y in 2020, down from eight expected to do so a week earlier. During 2019, just two sectors improved y/y: Financials and Utilities. The forward profit margin rose to record highs during 2018 for 8/11 sectors, all but Energy, Health Care, and Real Estate. Since then, it has moved lower for nearly all the sectors. Utilities is the only sector with its forward profit margin at a record high. Here's how the sectors rank based on their current forward profit margin forecasts versus their highs during 2018: Information Technology (22.2%, down from 23.0%), Financials (18.0, down from 19.2), Real Estate (15.5, down from 17.0), Communication Services (14.9, down from 15.4), Utilities (13.6, record high), S&P 500 (11.9, down from 12.4), Health Care (10.5, down from 11.2), Industrials (10.0, down from its record high of 10.5% in mid-December), Materials (9.9, down from 11.6), Consumer Staples (7.4, down from 7.7), Consumer Discretionary (7.3, down from 8.3), and Energy (5.2, down from 8.0).

US ECONOMIC INDICATORS

Housing Starts & Building Permits ([link](#)): Housing starts fell less than expected in February, remaining near January's 13-year high, while building permits also held around its cyclical high. February starts contracted 1.5% to 1.559mu (saar), after a four-month surge of 28.3% to 1.624mu—which was revised up from the preliminary estimate of 1.567mu. Single-family starts advanced for the fourth time in five months, by 6.7% m/m and 18.8% over the period, to 1.072mu (saar)—its best reading since June 2007. Volatile multi-year starts fell 14.9% to 527,000 units (saar) last month, after soaring to 619,000 units in January—which was the highest reading since summer 1986. Building permits also remained around cyclical highs last month, dropping 5.5% to 1.464mu (saar) from January's 13-year high of 1.550mu. Mimicking starts, single-family permits continued to set new cyclical highs, while multi-family permits remained volatile around recent highs. Single-family permits advanced for the 10th consecutive month, by a total of 27.7%, to 1.004mu (saar)—the highest level since May 2007. NAHB's Housing Market Index (HMI) ticked down to 72 in March, remaining near December's reading of 76—which was the highest since June 1999. Data were collected prior to March 4—so the stock market drop and the escalation of the coronavirus won't be visible until next month's report.

GLOBAL ECONOMIC INDICATORS

European Car Sales ([link](#)): EU passenger car registrations (a proxy for sales) dropped 7.4% y/y in February, similar to January's 7.5% drop, as major taxation changes announced by some EU member states for 2020 pulled registrations forward into December 2019. Aside from tax changes, sales were also impacted by a weakening global economy, along with consumer uncertainty. All four of the major EU economies saw a contraction in sales during February and January/February versus a year ago: Germany (-10.8% y/y & -9.0% y/y, ytd) Italy (-8.8 & -7.3), Spain (-6.0 & -6.8), and France (-2.7 & -7.8).

Eurozone CPI ([link](#)): February's CPI headline rate slowed to 1.2% y/y, matching its flash estimate, after accelerating the prior three months from 0.7% in October (which was the lowest since November 2016) to 1.4% in January. It was the 15th consecutive month the headline rate was below 2.0%. Meanwhile, the core rate edged up to 1.2% y/y after easing from 1.3% in November and December to 1.1% in January. Looking at the main components, food, alcohol & tobacco (unchanged at 2.1% y/y) posted the highest rate, followed by services (1.6 from 1.5), and non-energy industrial goods (0.5 from 0.3)—which both were higher than their January rates. Meanwhile, the rate for energy (-0.3 from 1.9) dipped back into negative territory after two months above. Of the top four Eurozone economies, rates in Germany (1.7) and France (1.6) were above the Eurozone's headline rate of 1.2%, while Spain's (0.9) and Italy's (0.2) were below—with Italy's the lowest among all Eurozone members.

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