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The Great Stay-In (Seventh of a Series)

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On March 12 we began this special series on COVID-19 with a sense that America would soon be forced out of schools, offices, and all group activity. Little did we know six weeks later 97% (according to one study) of the US population is either at home or sheltering in place.

This state of affairs has completely upended the free-flowing, dynamic nature of the largest, most diversified economy on the planet. Industries, whose most nimble constituents took decades to systematically develop competitive products and services to meet consumer and commercial demand, have been thrown into disarray.

In the early phase of the crisis, investors studied the most obviously vulnerable sectors for signs of weakness. These included travel, leisure, hospitality, gaming, transportation, and retail. Indeed, these industries took almost immediate revenue hits.

Amid worries last year surrounding China/US trade, close attention was paid to potential supply chain and distribution channel interruptions. That exercise was repeated as news from Wuhan made it apparent China was headed for a shutdown.

But as the breadth and depth of the infection became clear in mid-March, a wider swath of US businesses was affected. This was largely driven by intervention at state and local levels, effecting stay-ins and shut-downs to stem the COVID tide.

To complicate matters, the oil war between Russia and Saudi Arabia, combined with the threat of a deep recession, drove US crude futures to $11.57/bbl – a 21-year low. One May contract price went negative for the first time ever. While energy prices are driven by supply/demand factors, they point to economic headwinds beyond coronavirus woes.

So how are credit investors evaluating industries in light of the new normal? “We’re avoiding industries that are on the ‘frontlines’,” the head of one direct lender said in a recent Refinitiv LPC interview. “Airlines, hospitality, live entertainment, movie theaters, etc. We’re looking at industries that hold up relatively well during economic downturns: consumer staples, business services, pharmaceuticals, healthcare, online education.”

This view is supported by a Refinitiv lender survey identifying other consumer-facing businesses, particularly discretionary purchases (e.g. sporting equipment) and services (e.g. elective surgery), that have been negatively impacted.

On the plus side, areas such as food delivery, consumer staples, and on-line learning are thriving during The Great Stay-In. The unanswered question is whether these sectors will remain as attractive once whatever version of the old normal returns.

Regardless, while few foresaw the trigger to this downturn, select direct lenders with experience through cycles have constructed portfolios with defensive characteristics. These should remain the best bet to protect assets from value deterioration.

? Next week: How does the Great Stay-In compare to the Great Recession?