Buddy, Can You Spare $2 Trillion?

Strategy I: CARES to the Rescue. Last week, President Donald Trump signed into law the $2 trillion-plus Coronavirus Aid, Relief, and Economic Security (CARES) Act. The law offers substantial financial relief for consumers, healthcare providers, states, and small business. Large corporations can also put their hands out, but strings attached to their funding may be deterrents. Below, Jackie looks at what the Act will mean for specific industries:

(1) Medicine for healthcare providers. CARES gives $100 billion to eligible healthcare providers—such as hospitals, long-term care providers, and physicians’ practices—to reimburse them for expenses or lost revenues due to COVID-19. Costs could include building temporary facilities, leasing properties, supplies, and equipment and tests.

A March 30 publication by law firm Chapman and Cutler notes that the legislation provides additional relief by boosting certain Medicare and Medicaid reimbursements to healthcare providers. It requires health insurance plans to provide coverage, without cost-sharing or prior authorization, for all diagnostic tests. And test providers are required to list test prices on a public website. Lastly, the Act provides roughly $200 million to expand the use of Telehealth and limits the liability of manufacturers of essential medical devices and volunteer healthcare professionals.

(2) Grants to pull airlines out of nosedive. Through CARES, the Treasury is giving $32 billion to the airline industry to pay for employee wages, salaries, and benefits. Airlines will receive $25 billion through grants and another $9.5 billion through low-interest loans. Airlines will have to keep their employees on the payroll for 90 days to receive the grants, and the loans will be forgiven if airlines use the funds to pay employee wages, salaries, and benefits. Airlines are also prohibited from paying dividends or buying back shares if they accept government funding.
billion, contract workers to the industry can get $3 billion, and cargo airlines $4 billion.

But there are strings. According to the Treasury’s guidelines, companies accepting the funding cannot have layoffs, furloughs, or reduce the pay or benefits of employees until September 30; cannot pay dividends or buyback stock through September 30, 2021; and must accept certain limits on executives’ compensation for the next two years.

The Treasury also appears to want debt or equity in the companies in exchange for the government’s largess. The guidelines note that the Treasury is “authorized to receive warrants, options, preferred stock, debt securities, notes, or other financial instruments issued by recipients of payroll support which, in the sole determination of the Treasury Department, provide appropriate compensation to the Federal Government for the provision of the payroll support.” The funding application gets more specific: “Each applicant must identify financial instruments to be issued to the Secretary that, in the sole determination of the Secretary, provide appropriate compensation to the Federal Government for the provision of payroll support. Such financial instruments may include warrants, options, preferred stock, debt securities, notes, or other financial instruments issued by the applicant.”

Lastly, Treasury may require companies accepting support to ensure service to any point served by the carrier before March 1, 2020.

(3) Loans for selected industries. The CARES Act also provides up to $46 billion in loans from the Treasury to certain industries: $25 billion to passenger airlines and related businesses; $4 billion to cargo air carriers; and $17 billion to businesses critical to national security, according to Treasury’s guidelines.

To receive the loans, the borrower must show that credit is not reasonably available elsewhere and that the borrowing is prudent. The loan, which must mature in five years or less, must be secured or made at a rate that reflects the loan’s risk. Once again, there are strings. Borrowers are not allowed to buy back stock or pay dividends until 12 months after the loan is no longer outstanding. The borrower must also maintain the employment levels it had as of March 24, 2020 through September 30 if possible, and, at the worst, cut no more than 10% of employees.

Public-company borrowers must give the Treasury department warrants or equity, and private
companies the same or senior debt. In addition, terms include limitations on executive compensation and may involve requirements that borrowers provide service to an area they serviced to prior to March 1.

(4) No life preservers for cruise lines. Cruise lines are ineligible for CARES loans, as borrowers must be created or organized in the US and employ Americans as majority of their workforce. Carnival, Norwegian Cruise Line Holdings, and Royal Caribbean Cruises aren’t incorporated in the US, don’t pay federal taxes, and employ mostly foreign nationals. At a press briefing, President Trump said he’d like to provide assistance to cruise lines but would also like them to register in the US and pay federal taxes, a March 26 WSJ article reported.

On Tuesday, Carnival turned to the capital markets for funding. It’s issuing $1.25 billion of stock, $4 billion in secured notes, and $1.75 billion of convertible notes (both notes due in 2023). The price tag is high: The coupon being discussed on the secured notes is 11.5%, reflecting the fact that this funding will tide the docked cruiser over only through November, an April 1 FT article reported.

(5) Boeing: “Keep your money!” The government’s primer doesn’t explain which companies are considered critical to national security, but a March 25 Washington Post article suggested that the $17 billion of loans earmarked for companies critical to national security was proposed with Boeing in mind. Boeing, however, seems uninterested in the loans given the strings attached. The WP article quoted a Fox interview with Boeing’s CEO Dave Calhoun, who said “he would not be willing to give the government an equity stake in the company in exchange for a bailout. … ‘If they force it, we just look at all the other options, and we’ve got plenty of them.’”

(6) Fed in the game. The CARES Act also provides $454 billion to fund direct loans from the Fed to small and large US companies, states and municipal entities, and to support the markets for certain securities, according to a March 30 Chapman and Cutler report.

Familiar strings here as well: Borrowers are prohibited from paying dividends or repurchasing shares and face limitations on the compensation of certain executives (unless waived by the Treasury secretary). Loans to large businesses will not be forgiven, and borrowers must retain at least 90% of their workforce at full compensation and benefits until September 30.
Small businesses dealt a better hand. CARES allocates $349 billion of loans to small businesses and nonprofits to help them pay employee wages and other costs, according to a March 31 Treasury press release. All loan payments are deferred for six months, and any part of the loan used over the next eight weeks for payroll, rent, utilities and mortgage interest will be forgiven in full if employees are retained. The amount forgiven will be reduced if employees are laid off or their wages reduced. Companies, not-for-profit organizations, sole proprietorships, tribal concerns, and independent contractors with 500 or fewer employees are eligible for the two-year loans, which can be up to $10 million each. The loans don’t require any collateral or personal guarantees—a much better deal than large companies received.

Strategy II: Diving Dividends and Buybacks. The CARES Act may help the economy, but it isn’t welcome news to investors counting on dividends from companies that need government funding given the requirement that they stop making dividend payments and stock repurchases.

Apart from the CARES Act, there have been a rash of dividend suspensions and stock buyback terminations in response to the virus-induced economic slowdown. Dividends have been suspended by restaurants (e.g., Darden Restaurants, Bloomin’ Brands, and Texas Roadhouse), travel-related companies (Marriott International, Sabre, Delta Airlines, Alaska Air, Boeing, and Carnival), retailers (Macy’s, Nordstrom, and Coach), and others (WPP, Ford Motor, SL Green Realty, Old Dominion Freight Line, and Freeport-McMoRan). Dividends have been cut by energy companies (Apache, Occidental Petroleum, Targa Resources, and DCP Midstream).

Many of the same companies also stopped buying back their stock. Large banks—including JP Morgan, Bank of America, Citigroup, Morgan Stanley, and Goldman Sachs—together announced they’d stop stock buybacks, while maintaining dividend payouts, to free up extra funding to support clients in today’s tough economy.

There are likely far more dividend cuts and stock buyback terminations coming in the weeks ahead. Goldman Sachs estimated earlier this week that S&P 500 dividends will fall by 25%, a March 30 Barron’s article reported. In the Great Financial Crisis, S&P 500 quarterly dividend payments declined by 29%, and buybacks fell by 86%, Joe calculates. He believes stock repurchases will once again plummet.
Let’s take a look at how COVID-19 is affecting dividends and stock buybacks:

(1) *Dividend highs in the past.* Dividends paid out by S&P 500 companies climbed to a record $494 billion during the four quarters through Q1-2020 (*Fig. 1*). There were $728.7 billion of stock buybacks by S&P 500 companies over the past four quarters through Q4-2019. That’s off 11.5% from the peak of $823.2 billion in buybacks in Q1-2019, but still relatively high on a historical basis (*Fig. 2*).

Here’s the dividend-payment derby for the S&P 500 sectors during Q4-2019: Information Technology ($20.5 billion), Financials (18.5b), Health Care (15.5b), Consumer Staples (13.2b), Industrials (12.3b), Energy (11.3b), Communication Services (9.3b), Consumer Discretionary (8.6b), Utilities (6.9b), Real Estate (6.3b), and Materials (3.7b) (*Fig. 3*).

Here’s the stock-buyback derby for the S&P 500 sectors over the past four quarters through Q4-2019: Information Technology ($224.8 billion), Financials (178.4b), Health Care (83.9b), Consumer Discretionary (68.5b), Industrials (60.8b), Communication Services (38.2b), Consumer Staples (33.8b), Energy (18.8b), Materials (15.7b), Utilities (3.4b), and Real Estate (2.2b) (*Fig. 4*).

While stock buyback activity for the S&P 500 has held near 2018 highs, it has dropped in the Energy and Consumer Staples sectors. Energy-sector buybacks were 75% lower in Q4-2019 than in 2008, and Consumer Staples have seen buybacks fall almost every year since 2010.

(2) *More cutting ahead?* As of March 19, analysts were forecasting S&P 500 companies would pay out $524.0 billion of dividends over the next 12 months, up 6.0% from the prior 12 months. Given current circumstances, that figure is certainly far too high now.

Here are some industries that we think will have a tough time paying dividends and the pre-crisis forecasts of the dividends they were expected to pay out over the next 12 months: Restaurants ($7.0 billion), Retail REITs (4.7b), Aerospace & Defense (4.6b—attributable to Boeing, which recently suspended its dividend—out of the 14.0b total; defense companies’ dividends should be fine), Automobile Manufacturers (4.3b), Movies & Entertainment (3.4b), Hotels, Resorts & Cruise Lines (2.0b), Casinos & Gaming (1.8b), Airlines (1.6b), Department
Stores (1.1b), Advertising (1.0b), Hotel & Resort REITs (0.6b), Auto Parts & Equipment (0.4b), and Motorcycle Manufacturers (0.2b). These industries’ forecasted dividends over the next 12 months add up to $32.7 billion.

(3) Energy dividends/buybacks endangered. Plunging oil prices probably mean the Energy sector’s expected dividends of $46.8 billion deserve at least a 50% haircut. The price of crude oil per barrel has fallen 62% ytd to $24.90, and there’s growing concern that storage space is running out. Bankruptcies in the heavily leveraged industry are picking up, with oil driller Whiting Petroleum the latest to file, on Wednesday. Whiting’s bankruptcy brings the default rate for high-yield energy companies over the past year up to 11%, an April 1 FT article reported. The article also noted that shale gas producers Chesapeake Energy, California Resources and Gulfport Energy have each recently hired advisers to advise them on reducing their debt. To get relief, oil prices need Russia and Saudi Arabia to end their full-tilt oil war.

(4) Safer plays? Dividends in the Financials sector should hold up if the economic recovery from COVID-19 is more “V” than “L” shaped. Pre-crisis estimates pegged Financials’ dividends over the next year at $77.5 billion. The dividends of Information Technology ($84.8 billion), Health Care (68.2b), Staples (54.8b), and Utilities (29.1b) all seem relatively secure as well. These sectors’ dividends represent roughly half the dividends paid by the S&P 500 companies. Add the dividends paid by industries in peril due to COVID-19 to half of the dividends paid by the Energy industry, and add to that the probable dividend cuts by cyclical industries, and it’s easy to see how a 25%-30% reduction in S&P 500 dividend payments could be in the cards.

**CALENDARS**

**US:** Thurs: Jobless Claims 3.0m, Trade Balance -$40.0b, Challenger Job Cuts, EIA Natural Gas Storage. Fri: Payroll Employment Total, Private, and Manufacturing -100k/-117k/-10k, Unemployment & Participation Rates 3.8%/63.3%, Average Hourly Earnings 0.2%m/m/3.0%y/y, Average Weekly Hours 34.2, ISM & IHS Markit NM-PMIs 44.7/38.5, Baker-Hughes Rig Count. (DailyFX estimates)

**Global:** Thurs: China Caixin NM-PMI 39.5, Germany & France Sovereign Debt to be Rates by
S&P. Fri: Eurozone Retail Sales 0.1%m/m/1.7%y/y, Eurozone, Germany, France, and Italy CP-MIs 31.4/36.8/30.0/25.0, Eurozone, Germany, France, and Italy NM-PMIs 28.2/34.3/29.0/22.5, UK C-PMI & NM-PMI 36.0/34.8. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment (link): The Bull/Bear Ratio (BBR) rose this week for the first time in six weeks, though remained below 1.00. The BBR climbed to 0.87 this week after falling from 2.89 to 0.72 (the lowest since February 2016) the prior five weeks. Bearish sentiment sank 5.4ppts this week to 36.3% after soaring 22.8ppts (to 41.7% from 18.9%) the prior five weeks, while bullish sentiment ticked up 1.3ppt to 31.4% following a five-week plunge of 24.6ppts (30.1% from 54.7%)—to its lowest percentage since late December 2018. Meanwhile, the correction count rose 4.1ppts to 32.3% after falling 12.7ppts (to 28.2% from 40.9%) the prior two weeks. The AAII Ratio slipped to 38.7% last week after climbing from 36.7% to 40.2% and bearish sentiment rose from 51.2% to 52.1%.

S&P 500 Sectors Quarterly Earnings Outlook (link): With the March quarterly earnings books now closed, analysts continue to slash their estimates in what’s sure to be the worst season in many years. The Q1 EPS forecast fell 79 cents w/w to $37.23. That represents a decline of 4.9% y/y on a frozen actual basis and -2.9% y/y on a pro forma basis. That compares to a 3.1% gain in Q4-2019, a 0.3% decline in Q3-2019, and y/y gains of 3.2% in Q2-2019, 1.6% in Q1-2019, 16.9% in Q4-2018, and 28.4% in Q3-2018 (which marked the peak of the current earnings cycle). Besides the small y/y decline in Q3-2019, the last time earnings fell markedly y/y was during the four quarters through Q2-2016. Six of the 11 sectors are still expected to record positive y/y earnings growth in Q1, with one rising at a double-digit percentage rate. That compares to eight positive during Q4, when two rose at a double-digit percentage rate. Seven sectors are expected to beat the S&P 500’s pro-forma 2.9% decline in Q1, down from six in Q4 and seven in Q3 but up sharply from just three beating the S&P 500 during Q2-2019. Three sectors are expected to post improved (or less worse) growth on a q/q basis during Q1: Communication Services, Energy, and Materials. On an ex-Energy basis, the consensus expects earnings to drop 1.8% y/y in Q1. That compares to ex-Energy gains of 6.0% in Q4, 2.2% in Q3, 3.9% in Q2, and 3.0% in Q1 but is well below ex-Energy’s 25.0% and 14.2% y/y gains in Q3-2018 and Q4-2018, respectively. Here are the latest Q1-2020 earnings growth rates versus their final Q4-2019 growth rates: Communication Services (10.5% in Q1-2020 versus 8.2% in Q4-2019), Information Technology (3.9, 9.2), Health Care (3.3, 10.1),
Utilities (2.3, 17.8), Real Estate (1.8, 7.0), Consumer Staples (0.2, 2.6), Financials (-0.9, 10.3), Materials (-11.5, -12.4), Consumer Discretionary (-19.2, 2.5), Industrials (-23.0, -9.3), and Energy (-32.6, -41.2).

US ECONOMIC INDICATORS

**ADP Employment** ([link](#)): The private sector lost 27,000 jobs in March, as small businesses shed 90,000 jobs, while large (56,000) and medium (7,000) businesses added to payrolls. March’s decline was much smaller than expected—though “the March NER does not fully reflect the most recent impact of COVID-19 on the employment situation, including unemployment claims reported on March 26, 2020,” according to the report. March’s reading is based on “the total number of payroll records for employees who were active on a company’s payroll through the 12th of the month,” the same period the BLS uses for their survey. That said, while only small businesses saw a decline in employment this month, a wide swath of industries experienced declines, with both service-providing (-18,000) and goods-producing (-9,000) businesses shedding jobs. Trade, transportation & utilities (-37,000) posted the biggest decline among service-providing industries, followed by administrative/support services (-12,000), leisure & hospitality (-11,000), and information services (-7,000), while health care/social assistance (44,000) added the most jobs, followed by professional/business services (11,000), and education (4,000). Within goods-producing industries, construction companies cut 16,000 jobs, while manufacturing (6,000) and natural resources/mining (1,000) added to payrolls.

GLOBAL ECONOMIC INDICATORS

**Global Manufacturing PMIs** ([link](#)): “The outbreak of coronavirus disease 2019 (COVID-19) continued to cause disruption across the global manufacturing sector in March.” The JP Morgan Global-PMI (to 47.6 from 47.1) ticked up slightly in March, almost entirely due to a stabilization in China’s M-PMI (50.1 from 40.3). The Global M-PMI excluding China sank to 46.6 in March—its lowest level since May 2009. The emerging economies’ M-PMI (to 49.1 from 44.6) got a lift from the improvement in China’s M-PMI, while the advanced countries M-PMI (46.0 from 49.5) continued to deteriorate. Of the 29 nations for which March data were available, only three—the Netherlands (50.5), Taiwan (50.4), and China (50.1)—stayed above water. The Philippines (39.7) posted the steepest decline in manufacturing, followed by Italy (40.3), Czech Republic (41.3), Vietnam (41.9), Poland (42.4), Greece (42.5), France (43.2), South Korea (44.2), Japan (44.8), Ireland (45.1), Myanmar (45.3), Indonesia (45.3), Germany
(45.4), Spain (45.7), Austria (45.8), Canada (46.1), Thailand (46.7), Russia (47.5), UK (47.8),
Turkey (48.1), Malaysia (48.4), Brazil (48.4), US (48.5), Kazakhstan (48.8), Colombia (49.3),
and Australia (49.7).

**US Manufacturing PMIs** (link): Manufacturing activity in March contracted, though both the
ISM & IHS Markit measures got a boost from a slowing in deliveries, which masks underlying
weakness. (Usually, slower deliveries are a sign of strengthening demand, though this time it
reflects widespread supply shortages due to the corona virus.) ISM’s M-PMI fell for the second
month, from 50.9 in January to a better-than-expected 49.1 last month, as the supplier
deliveries (to 65.0 from 57.3) component shot up to a 21-month high. Meanwhile, both the
orders (to 42.2 from 49.8) and employment (43.8 from 46.9) measures contracted at their
fastest paces since 2009, while production (47.7 from 50.3) fell back below the breakeven
point of 50.0. The new export orders’ (46.6 from 51.2) sub-index is contracting again after
rebounding to a 16-month high of 53.3 at the start of this year; inventories (46.9 from 46.5)
contracted at the same pace as February. On the inflation front, ISM’s price (to 37.4 from 45.9)
index fell further below 50.0, dropping to just over a four-year low. In the meantime, IHS
Markit’s M-PMI (to 48.5 from 50.7) reveals manufacturing activity contracted at its fastest pace
since August 2009 last month—as the effects of the corona virus triggered the sharpest
downturns in output and new orders since the financial crisis in 2009; employment fell at the
quickest pace in over a decade. According to the report, “The outbreak of COVID-19 also
weighed on output expectations across the sector. Fears surrounding the longevity of
shutdowns and the slow recovery thereafter led to the lowest degree of confidence since data
collection for the series began in July 2012.”