Oil, Jobs, State Treasurers and Re-Opening

USO is NOT Oil

It is extremely difficult to get a good read of what is going on in the oil market, when USO has become the tail wagging the dog. I continue to believe that low oil prices are a Wake Up Call, but we have to be careful interpreting what day to day price action might mean.

Earlier this week, we saw the May WTI futures contracts trade at negative prices. Effectively, people were getting paid NOT to deliver oil.

In the past few days, USO, a large ETF that trades oil futures to meet its stated goals, has changed their investment approach multiple times. They no longer are largely in the front contract.

Here is what is going on with USO, that you need to think about, as you interpret what is going on with oil prices:

- Between January 2019 and February 2020, USO had assets under management of between $1.2 billion and $1.8 billion. That spiked to as high as $4.3 billion on April 17th and is hovering around $3.5 billion (the AUM is a function of the price of the contracts they hold and massive net inflows).
- Over that same timeframe, the front WTI futures contract went from trading near $60 for virtually all of 2019, to about $20 right now. So, the AUM represents a much bigger part of the futures markets.
- Per the USO website, as of April 22nd (I cannot tell if there is a lag or not), they had 84,870 July contracts (they had some June and August contracts and also had both NYMEX and ICE contracts, and I think that after their latest announcement, they have shifted the mix further). **That 85,000 contracts represents more than 20% of the open interest in that contract.**
- Similarly, it reports trading 22,500 August contracts on the 22nd (since they have only 7,000 contracts reported, I think that there is in fact at least a 1 day delay). In any case, that seems to be **about 10% of the volume traded.** When you account for algos and scalpers (fast day traders trying to make a couple of ticks) the USO flows are even larger relative to the true depth of liquidity.

Basically, you have one fund that:

- Has very large positions relative to open interest.
- Has very large trading volumes relative to total trading volumes.
- Has a relatively public strategy that creates a target.

I am not sure how much of the steepening of the WTI futures curve is a direct result of USO shifting positions, but I would hazard a guess that some is.

I have no idea what the outcome of all this will be, but I think that we need to be cautious in how we interpret 'signals' from the oil market as the signal-to-noise ratio is skewed against us.

Personally, my view is that we will see a re-flattening of the WTI curve, and that the front end will behave a little better this time around, since you have to go back to September to find smaller open interest in the front contract (June open interest is 40% lower than the peak open interest in May).

Jobs

Jobless claims were awful again. Continuing claims, already much higher than we had during the financial crisis, will only get worse.

Yes, the Federal government paying $600 per week in addition to the state unemployment mitigates the damage to a large degree. However, there are stories of companies finding it hard to lure workers back to work when they can 'make so much' being unemployed.

I disagree, as I strongly believe we are at **an inflection point in jobs**:

- Each round of job losses is going to hit harder and dig into the meat of the economy. Companies worried about earnings are going to have to contemplate further cutbacks. The energy industry, which I think is so critical to the economy, is cutting and may have to cut further. These are jobs that won't see their paychecks fully covered by any combination of unemployment benefits and they might find it very difficult to find a similar job, if the economy stays shuttered.
- Who wouldn't want to get paid not to work for a few months and then pick up right where they left off? It is rational, except for the part about assuming you will get back to where you were. I expect that for a lot of people who have been let go, the fear of not getting a job back will be a big factor in their decision to work or not, if they get the call back to work. I think the plan could have been done better to align incentives, but I suspect there will be a very high correlation between those willing to 'forego' benefits to work again and those companies which really want their employees to come back to work.

If I'm correct, and we are at an inflection point, where the next rounds of cuts are more painful and harder to reverse, then we need to be thinking about that.

State Treasurers

Academy Securities had the pleasure of being involved with State Financial Officers Spring Conference (virtual of course). I got to listen to General Marks lead a great session on Geopolitical Risks. I was able to discuss what I think will wind up being Phase 5 in the war on the virus – supply chain repatriation and infrastructure rebuilding. More importantly, from my perspective, we got to listen to what others had to present and got a good sense of what is top of mind for this group.

I found the conversations stimulating, even if sometimes a bit depressing, given how hard some economies have been hit by the war on the virus and how handcuffed some are by rules that the federal government isn't bound by (balanced budgets). The depth of the discussions on the economy and thoughtfulness on the concept of re-opening was encouraging. There is a real trepidation to open too quickly, mixed with a desire to start rebuilding as the costs of the economy being shut down mount.

For me, the biggest shock was the problems hospitals are facing. I guess I hadn't thought about it, but hospital usage has declined across the country. It has hit for-profit hospitals, but also those funded locally. I just hadn't thought about that. Not sure what it means or what to do about it, but figured I'd mention it, as it seems like the muni bond market is further ahead of this issue than the rest of us (or at least me).

Re-Opening

I wrote a lot about this in Fear, Anger, Confusion, Betrayal, Compassion, Remorse, Defiance, so I won't spend a lot of time here.

One thing that I do want to say about this subject today, is that **we need to evaluate ideas on their merit, rather than who gave the idea.** That seems so obvious, it hardly seems worth mentioning, yet, after more than a week of heartfelt conversations and arguments, it seems like something that needs to be said.

In an ideal world, we'd have coordinated, well organized plans to implement. We'd focus on areas and regions where re-opening should matter to the economy. We'd want areas where social distancing remains easier, even as we re-open. We'd want different geographical regions and maybe even climates. Rules to protect the most at risk are an important part of any attempt. Areas re-opening will have to accommodate workers and maintain as much social distancing as possible. Those who need to work remotely (or really want to) need to be accommodated. Availability of medical resources, in case it goes wrong, needs to be a consideration.

In theory, we also need lots of testing, a lot more than we currently have, but that might be something that isn't the roadblock that it currently is seen to be.

Bottom Line

I'm still in risk-on mode. I was wobbly as oil cratered, but I'm still there and am encouraged by further progress in the War on the Virus and some signs that the Battle for the Economy is starting (tentatively, but starting).

This is not easy and there are no "great" answers, just ones fraught with risk and costs that somehow, we have to manage our way through.

Be Safe and Fight On!

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