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WEALTH MANAGEMENT

April 27, 2020

Each passing week seems to bring more economic damage as the effects of the COVID-19 virus continue to unfold. Two areas of the economy that have been recently impacted are unemployment as well as oil prices.

What began as our worst-case scenario for U.S. unemployment is quickly becoming a reality. The tidal wave of unemployment fillings across the U.S. showed a slight decrease over last week. April 23's unemployment claims report indicated more than 4 million people applied for benefits last week, down from over 5 million the week prior [1]. April 23's report brings the five-week unemployment filing total during COVID-19 pandemic to 26.5 million [1]. To put this figure in perspective, the U.S. economy created 23.3 million new jobs from February 2010 to February 2020. "In four weeks, all of the job gains from a decade-long recovery following the Great Recession have been erased," said senior economist Daniel Zhao of Glassdoor [2].

Jay Bryson, acting chief economist at Wells Fargo & Co. said he believes the U.S. is past the peak in initial unemployment claims "for the foreseeable future," but "if we open up too soon and the coronavirus comes raring back then we may in fact see those sorts of numbers again." [3]

Assuming all who have filed for the benefit have been counted, Thomas Thornton of Hedge Fund Telemetry in a recent client note says, "I have seen estimates for the unemployment rate vary from 15% to 25% which will be reported May 8th." He goes on to say, "If we hit 20% that would be double what we saw in the wake of the global financial crisis. At 25% it would roughly equal what was seen in the Great Depression, though the methodology for that figure was different." [4]

The mind-boggling surge of layoffs could hardly be worse. However, it is important to note that most of the job losses seen in the last month are unlikely to be permanent. We are hopeful many workers will be rehired once the U.S. economy is reopened but unsure how long it may take. Oxford Economics predicts employment might not return to pre-COVID-19 crisis levels until at least 2022 [5]. According to a Bloomberg News survey conducted this month, the majority of economists surveyed said they anticipate a recovery that will be moderate and drawn out, with unemployment initially surging before declining to around 8% in the final three months of 2020 [6].

The formerly unthinkable drop in oil prices below $0 a barrel occurred on Monday, April 20, 2020 [7]. The impact of oil trading at negative prices is still reverberating through financial markets. In our view, oil demand was destroyed by the

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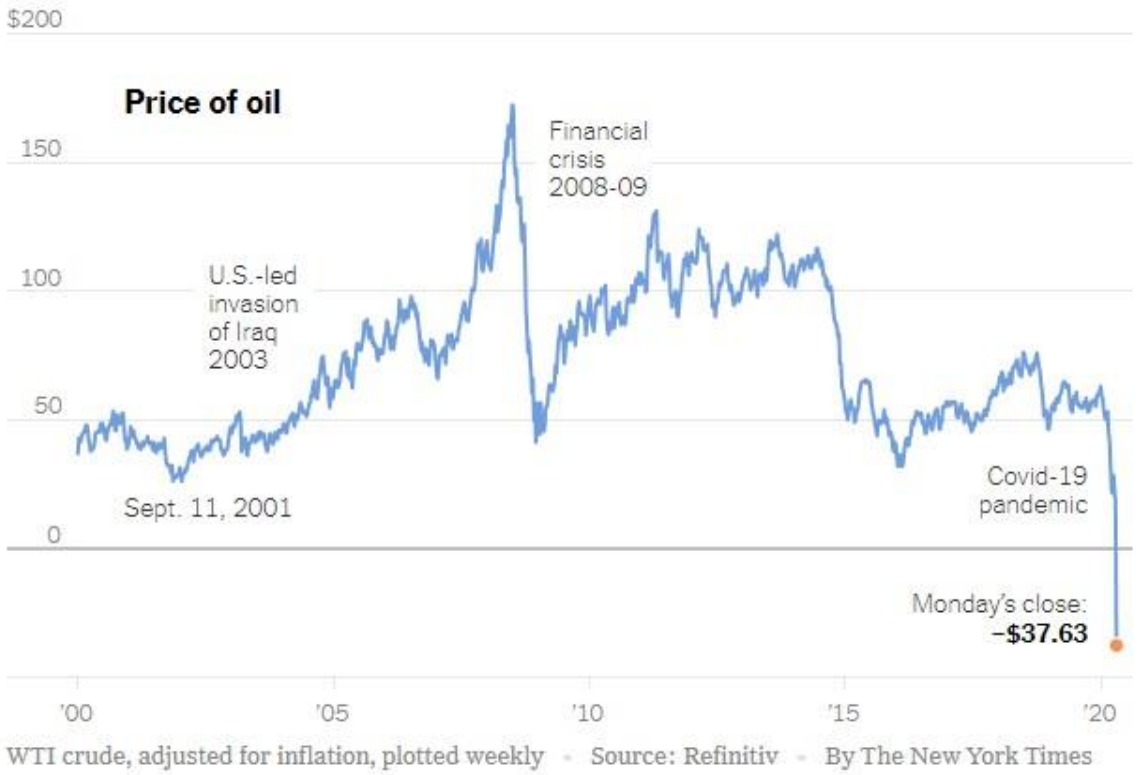
COVID-19 pandemic and eventually overwhelmed by an increasing oil supply. The dramatic drop in crude oil prices has forced some energy companies into considering bankruptcy as storage reaches maximum capacity. So how did we get here?

As COVID-19 started its spread in mid-February and the world economy began to slow, oil demand began to slip. Only several weeks later, Saudi Arabia and Russia, two of the world's biggest oil producers, escalated a price war. When OPEC and Russia could not agree on production cuts, crude prices fell. The following day Saudi Arabia stunned world leaders saying they had plans to increase production – this made the problem even worse, accelerating oil supply and causing the price of crude to fall further. Although Saudi Arabia and Russia eventually came to a production cut agreement in early April, much of the damage was already done [8].



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You may be wondering how a commodity can trade at a negative price. As May West Texas Intermediate futures contracts were set to expire, oil producers literally paid buyers to take their product. Facing an oversupply of oil with nowhere to store it, prices dove below negative $37 per barrel. The glut of oil has made storage space scarce and increasingly expensive. In fact, almost three dozen oil tankers carrying enough crude to satisfy 20% of global daily demand are gathered off California's coast with nowhere to go [9]. We feel this "floating storage facility" is a perfect illustration of oil's current oversupply. However, we do not anticipate your local gas station will begin paying you to fill up your vehicle.

Although we pride ourselves on being long-term investors, many of the recent market movements have left us scratching our heads, especially oil. While we do not know what future holds for Texas tea, we are pleased consumers are paying less at the pump. Nationwide, gasoline prices on average are down in excess of $1 per gallon over the past year, currently sitting at $1.81 per gallon. The price has fallen every day since late February. Consumers can expect to see gasoline prices fall further in the coming weeks, as the price typically lags crude oil. However, with taxes making up a portion of the pump price, there is only so low prices can go.

I recently came across a quote from Ed Hyman at Evercore ISI. I thought I would share the message because of its relevancy, as well as the fact that I am as impatient as they come. "The passage of **time** is getting us closer to when the global monetary stimulus over the past eight months starts to kick in. The passage of **time** has gotten us to the point when US fiscal stimulus kicks in. The passage of **time** is getting us closer to when Coronavirus quarantining starts to work and reopening begins. The passage of **time** could be getting us closer to scientific breakthroughs." [10]

While we may continue to see ugly economic numbers or bizarre market movements, we remind our clients to stay focused on long-term goals and that things will get better.

Sincerely,

D.P.

Dustin Padgett and Your Team at Big Sioux Wealth Management

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