Oil prices fell dramatically on Sunday night (US) when trading opened in Asia. The news that OPEC and Russia could not agree to output cuts fueled concerns over a price war and supply glut. As of this morning, Brent North Sea crude is off ~20% at $36/barrel. Equity and bond prices also moved on the news. At the open of trading, the S&P 500 was down ~6% while the yield on the 10Y continued to drop—now at 0.5%. In fact, the entire Treasury yield curve is now below 1% (30Y at 0.85%).

Exacerbating the oil price war and supply glut is the fact that 2020 is likely to be the first year since 2009—and only the third year in the last 35—in which year-over-year oil demand will be negative. As a frame of reference, when prices fell in 2016 to $29/bbl (from over $100/bbl in mid-2014) under similar circumstances, demand remained solid, which offset the increased supply. Not so today, given the COVID-19 headwinds. So, whereas an argument could be made that the drop in oil is a net-positive for the global economy given its importance to consumer and corporate cost structures, the backdrop of weakening demand due to the virus is very likely to mute any benefit.

Importantly, the energy sector is significantly smaller as a proportion of the equity markets than at any time in the recent past—it currently represents only 4% of the S&P 500, and 5% of global stock indices. At the last peak in oil prices in mid-2014, the energy sector was 11% of the S&P 500 and 10% of global stocks. For high yield bond markets, the exposure is more significant at 12% of the market.

Tangentially, markets will focus on the exposure that financial institutions have to energy credit. But here, broadly speaking, we would not expect oil exposure to impair the financial sector. Banks have increased their capital buffers since the financial crisis and regulators regularly run stress tests. US banks have more exposure to the energy complex than European banks do (it's a larger sector in the US) but, importantly, US banks are in better positions given their higher capital buffers. All that said, it’s likely that some smaller, regional banks will face headwinds given the energy issues entering today and the incremental challenges caused by the price collapse. More specifically, while most of the larger banks have only 1%–2% of their loan book exposed to energy, some regional players are >10%.

At times like these, central bankers focus on doing what they can to ensure the normal functioning of markets. In keeping with that, this morning the Federal Reserve increased the amount of temporary cash it’s willing to provide markets through its overnight and term repo operations. As the Fed mentioned in its press release, the goal of this increased operation is “to ensure that the supply of reserves remains ample and to mitigate the risk of money market pressures.”

But monetary policy will not be enough to offset the weakness in the economy due to COVID-19 (and now the energy weakness). Fiscal policy is a necessary element of getting through this period, not just in the US but globally. There have been small signs of this occurring, but more needs to be done.

As today shows, markets will continue to grapple with unfolding uncertainties. While these markets are difficult to ignore, we’re confident in the long-term plans we’ve established with clients, taking into account their goals, needs, and individual tolerances.
Note to All Readers:

The information contained herein reflects, as of the date hereof, the views of AllianceBernstein L.P. (or its applicable affiliate providing this publication) ("AllianceBernstein") and sources believed by AllianceBernstein to be reliable. No representation or warranty is made concerning the accuracy of any data compiled herein. In addition, there can be no guarantee that any projection, forecast, or opinion in these materials will be realized. Past performance is neither indicative of, nor a guarantee of, future results. The views expressed herein may change at any time subsequent to the date of issue hereof. This material is provided for informational purposes only, and under no circumstances may any information contained herein be construed as investment advice. AllianceBernstein does not provide tax, legal, or accounting advice. The information contained herein does not take into account your particular investment objectives, financial situation, or needs, and you should, in considering this material, discuss your individual circumstances with professionals in those areas before making any decisions. Any information contained herein may not be construed as any sales or marketing materials in respect of, or an offer or solicitation for the purchase or sale of, any financial instrument, product, or service sponsored or provided by AllianceBernstein L.P. or any affiliate or agent thereof. References to specific securities are presented solely in the context of industry analysis and are not to be considered recommendations by AllianceBernstein. AllianceBernstein and its affiliates may have positions in, and may effect transactions in, the markets, industry sectors, and companies described herein.

The [A/B] logo is a service mark of AllianceBernstein, and AllianceBernstein® is a registered service mark, used by permission of the owner, AllianceBernstein L.P.

1345 Avenue of the Americas, New York, NY 10105
1.212.486.5800
www.Bernstein.com
© 2020 AllianceBernstein L.P.