

The First Tee...

The Walking Business Dead...companies are racking-up record amounts of debt, that could hamper the pace and resiliency of the economic recovery once the pandemic ends:

- The size of corporate borrowing in the bond market last year broke records...approaching \$2 trillion:
 - The large amount of accumulated liabilities in market obligations and bank loans will force many firms to divert money away from future capital expenditures and payroll expansion to service debt:
 - Interest coverage ratios for high-grade and non-investment grade issuers are at their lowest level since 2003.
 - The over-leveraging of the corporate sector has been building since the financial crisis a decade ago:
 - Increased debt loads have been backstopped by low interest rates that were enabled by lax monetary policy.
- **Zombified...many iconic companies have joined the ranks of firms classified as “zombie” status:**
 - Zombie companies are firms that are not earning enough income to cover their interest expense:
 - Sectors seeing a large increase in zombie defined companies include airlines, retail, energy and leisure & hospitality:
 - Of the 3000 largest publicly listed firms, 20% are zombie...200 firms have joined the category since last March:
 - Zombie firms have added almost \$1 trillion in debt to their balance sheets since the pandemic began, bringing their total obligations to \$1.36 trillion...the debt total is over double the \$500 billion zombie companies owed at the height of the financial crisis.
 - Investors searching for higher rates have moved-out the credit curve and purchased riskier debt:
 - The elevated junk buying trend has allowed zombie companies to remain solvent during the current coronavirus crisis:
 - High grade issuers sold more debt in 2020 than any other year in history (2nd quarter debt to earnings ratio was highest since 1998).
- **A Japanese Lesson...the Federal Reserve has been purchasing corporate bonds (including junk rated issues) to help avoid bankruptcies...this has allowed unproductive companies access to credit markets by directing flow of capital:**
 - Zombie companies surfaced in Japan in the 1990's, also during the post financial crisis in Europe:
 - Firms were characterized by an inability to earn enough to retire debt, but still had credit access to roll-over debt.
 - Japan and European (Italy, Spain, Greece) economies struggled because capital was tied-up in zombie firms that could not afford to invest and build their businesses (*Japan's issue was also cultural; business executives and bankers did not want to lose face over failures*).
 - Length and breadth...troubled firms are surviving in zombie status longer and remain more vulnerable to failure:
 - About 60% of companies do manage to exit zombie status, but many continue to experience weakness in productivity, lower profitability and long-term underperformance...recovered firms are three times more likely to become zombies again.
- **Super Zombies...there is a growing number of companies doing worse than their zombie counterparts:**
 - These companies are losing money even before servicing their debt (most likely candidates for future bankruptcy):
 - This occurrence is called having negative EBITDA (earnings before interest on taxes, depreciation, and amortization...profitability):
 - From a universe of about 600 borrowers, 47 reached super zombie status during the 3rd quarter...double the number in the 2nd qtr.:
 - Typically, negative EBITDA companies are headed for bankruptcy, but some have been able to raise equity and borrow as investors are willing to take higher risks in hopes of a business turn-around later this year as the vaccine becomes more prevalent.
 - Over-leveraged companies need a fast solution to make their debt levels work (government support is not unlimited):
 - Most high-yield (junk) companies are struggling, while investment grade corporations are managing to hold their own.
 - **Debt Dilemma...companies who came out of the financial crisis with high debt loads typically underperformed their peers...large corporate debt loads are expected to be a drag on economic growth for the next several years:**
 - In this pandemic induced cycle, firms in industries such as tourism, travel and hospitality could see growth rates as much as 10% slower than during pre-COVID levels once the recovery begins:
 - The large amount of debt could alter the shape of the economy's recovery, from a “V” to a “U” (and possibly “K”).
 - There is a large amount of cash currently circulating in the economy, but liquidity does not always equate to solvency for beleaguered companies (*which could be a tough lesson for the yield hounds*):
 - The need for companies to deleverage debt are pointing to slower economic growth, subdued inflation and low interest rates in the foreseeable future (*As Wimpy always said, “I will gladly pay you Tuesday for a hamburger today.”...it was never divulged if Wimpy ever paid his debt or if he just borrowed more for additional hamburgers...becoming one of the debt walking dead!*)

At the turn...

The Back Nine...

Priming the Pumps...crude supply and demand continues to jockey back and forth:

- Pandemic's impact on energy continues to be felt, producers looking beyond COVID-19:
 - The Energy Information Administration forecasts U.S. crude output at 11.1 million barrels a day for this year and rising to an average of 11.5 million barrels in 2022 (output was running at 13 million prior to pandemic):
 - U.S. oil production fell to an average of 11 million barrels a day in 2020...down from 12.9 million in 2019.
- Oil price gains are expected to remain limited due to large global inventories and the current levels of surplus crude production capacity (shale producers focused on reducing debt and meeting loan covenants):
 - In 2020, WTI crude averaged \$42.14 per in price (the lowest since 2003)...down from the \$54.11 average price seen in 2019:
 - The EIA is projecting West Texas Intermediate crude to average \$49.70 a barrel this year and \$49.81 in 2022:
 - The price of regular gasoline in the U.S. averaged \$2.17 per gallon during 2020, down from the \$2.60 average seen in 2019.
 - Global crude supply is forecast to average 97.13 million barrels a day...while worldwide oil demand is anticipated to hit 97.8 million barrels a day (if accurate, this will cut into some of the excess global crude stockpiles).

Year of Living Dangerously...despite pandemic, stocks hit record high...bonds, record lows:

- Data format: January 1, 2020 / October 1, 2020 / January 1, 2021:

Equities

Dow: 28634 / 27781 / 30606
S&P 500: 3230 / 3362 / 3756
NASDAQ: 8972 / 11167 / 12888
Russell 2000: 1668 / 1507 / 1974

Commodities

CRB: 185 / 148 / 167
Oil: \$61.06 / \$40.22 / \$48.52
Gold: \$1517 / \$1885 / \$1898
Copper: \$283 / \$303 / \$351
Natural Gas: \$2.18 / \$2.52 / \$2.53

Borrowing Benchmarks

Libor:

1mo: 1.762% / .146% / .143%
3mo: 1.908% / .220% / .238%

SOFR: (U.S Secured Overnight Financing Rate)

1day: 1.55% / .08% / .07%

Treasuries Issues

3mo: 1.51% / .09% / .09%
6mo: 1.60% / .10% / .09%
1yr: 1.59% / .11% / .10%
2yr: 1.58% / .12% / .12%
3yr: 1.62% / .15% / .17%
5yr: 1.69% / .27% / .36%
7yr: 1.83% / .47% / .65%
10yr: 1.92% / .68% / .93%
30yr: 2.39% / 1.46% / 1.65%

Job / Inflation Indicators

Unemployment: 3.5% / 7.9% / 6.7%

Consumer Price Index: 2.3% / 1.4% / 1.4%

Core PCE Index: 1.6% / 1.6% / 1.4%

Federal Funds Open: 1.56% / .08% / .08%

Prime Rate: 4.75% / 3.25% / 3.25%

Currencies

Euro: 1.121 / 1.172 / 1.221
Yen: 108.61 / 105.48 / 103.25
Peso: 18.926 / 22.114 / 19.914
Canadian \$: 1.299 / 1.357 / 1.272
Yuan: 6.963 / 6.791 / 6.527

Grain Futures

Corn: \$3.87 / \$3.79 / %4.84
Soybeans: \$9.55 / \$10.22 / \$13.11
Wheat: \$5.58 / \$5.78 / \$6.40

19th Hole...

The easiest person to deceive is one's self. Edward Bulwer-Lytton

Ross Elford, First Vice President

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