FAQ: COVID-19 Sector Impacts

Many investors have wondered about the impact of COVID-19 on their lives as consumers of technology and of commodities like oil. During this period of sheltering at home, demand for oil has decreased as reliance on emerging and new technology increases.

In this FAQ, 1919 Investment Counsel addresses the unusual situation of negative oil prices and forced adaptation of tech-driven services and goods, against the backdrop of strong stock market performance even as overall economic conditions clearly decline.

What does it mean when we hear that oil futures are trading at a negative number?

It means that the immediate demand for that barrel is so low that it must be stored instead of sold. However, current storage capacity is so full that it is more expensive to store the barrel than the value of the barrel itself. The “beneficiary” of that negative number is the entity willing to receive cash to accept the barrel and find a place to store it or a consumer (such as a refiner) who is able to accommodate the capacity to take that barrel. As nice as it would be, you will not get paid to fill up your car’s gas tank.

For further background, oil futures in the U.S. are contracts that specify a commitment to deliver a physical barrel of oil of a certain quality to a specific oil terminal location on a specific date. Most contract holders trade in contracts several months in advance, and have no interest in the physical barrel. Instead, they intend to sell the contract before expiration to a buyer who will take the barrel and consume it (typically a refiner) or store it for future sale. As global oil demand declined due to COVID-19 while supply continued unabated, the primary storage capacity of excess oil quickly filled up, as did secondary and tertiary storage options. The result was extreme storage scarcity, causing the value of incremental storage to increase above the weakened value of the oil barrel itself.

How do we explain the Technology sector’s rally amidst a weakening economy?

The economic standstill resulting from COVID-19 has forced businesses to embrace technology like never before. In normal times, technology follows an “S-shaped” adoption curve, starting out slowly before a critical mass of users lead to sustained growth. But COVID-19 instantly created a critical mass of users overnight, kick-starting adoption of emerging technologies, and accelerating adoption of others. Investors recognize that once the genie is out of the bottle, users aren’t likely to go back to old ways since the productivity benefits are so substantial. In recent weeks we have seen video conferencing with Zoom, online collaboration with Slack, and telemedicine sessions with Teladoc all surge. These services have become vital during the pandemic, but their usage is likely to remain high afterwards since they offer real productivity gains over the services they replaced. In effect, the pandemic has compressed the timeframe needed to build a critical mass of users from years to weeks.

Even the very largest technology companies, including Amazon, Facebook, and Alphabet have seen accelerated adoption during the pandemic. Each of these businesses has leveraged the internet to scale rapidly, and the services they offer eliminate geographical barriers that otherwise exist, allowing instant, global distribution of products and services. With over 50% of the world’s population sheltering in place, these internet-enabled businesses have become global, essential services.

Consumers have turned to Amazon for groceries and apparel, musicians have turned to Facebook for virtual concerts, and Google – seemingly overnight – provided a way for tens of millions of students to continue classroom learning via Google Classroom. Consumers were already moving in these directions before the pandemic, but the sudden shelter-in-place orders clearly accelerated the pace; as a result, technology companies have fared better than most.

The relative stability of the largest technology companies has led to a rebound in cap-weighted indices and certainly the technology sector. We are still not back to pre-pandemic levels in terms of sales and earnings, but in many cases stock prices are higher today as investors bet that the leading technology companies will exit the pandemic even stronger.