

THE REAL ECONOMY

VOLUME 64



THE SWIFT AND
SIGNIFICANT MONETARY
AND FISCAL POLICY
RESPONSES TO THE
CORONAVIRUS

COMMERCIAL PAPER FUNDING FACILITY CREATED
TO EASE CREDIT STRESS

JUST HOW DEEP IS THE SUPPLY SHOCK? WEST COAST
PORTS TELL THE STORY

INDUSTRY SPOTLIGHT: CORONAVIRUS IMPACT ON
MIDDLE MARKET BUSINESSES

MIDDLE MARKET TREND WATCH: ECONOMIC TRENDS
AMID A PANDEMIC

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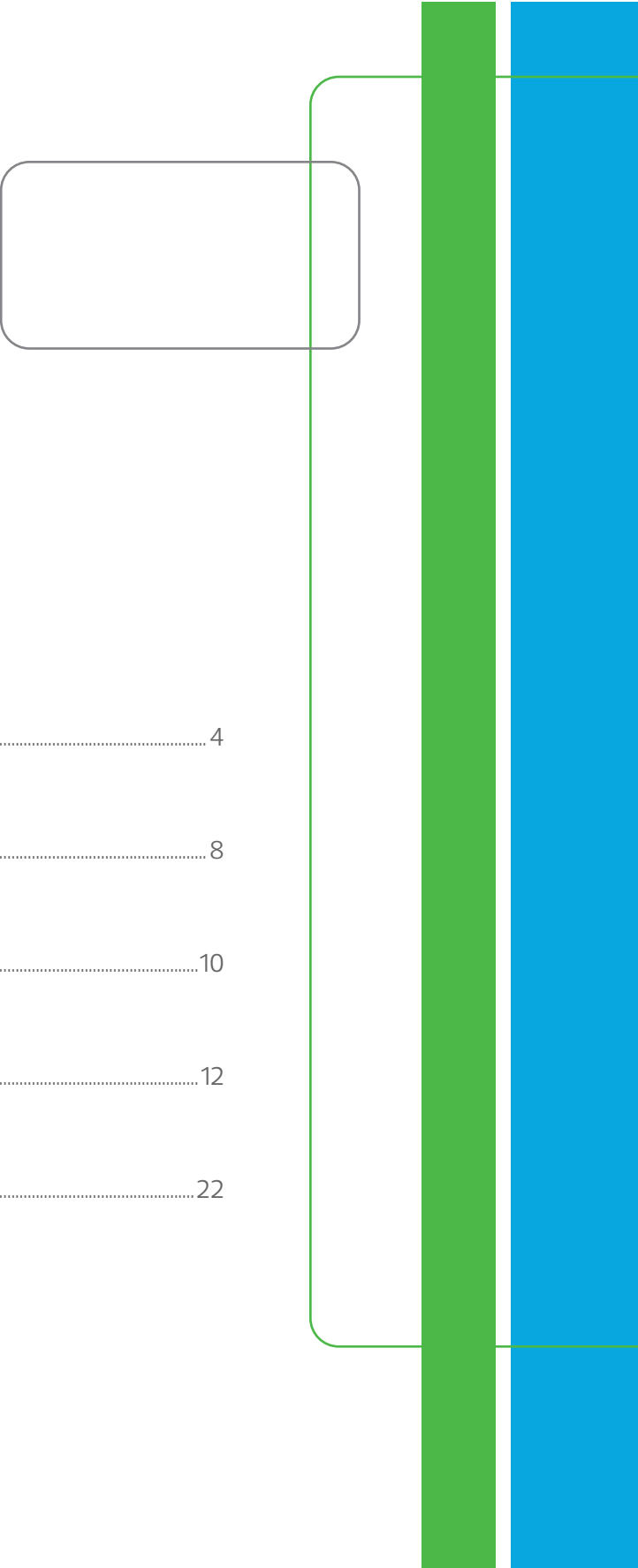


TABLE OF CONTENTS

The swift and significant monetary and fiscal policy responses to the coronavirus.....	4
Commercial Paper Funding Facility created to ease credit stress.....	8
Just how deep is the supply shock? West Coast ports tell the story	10
Industry spotlight: Coronavirus impact on middle market businesses	12
Middle market trend watch: Economic trends amid a pandemic.....	22

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THE SWIFT AND SIGNIFICANT MONETARY AND FISCAL POLICY RESPONSES TO THE CORONAVIRUS

BY JOSEPH BRUSUELAS

MARCH HAS BEEN a month for the ages, one that fiscal and monetary policymakers will never forget. Congress put forward roughly \$2.2 trillion, equal to 11.4% of gross domestic product, in fiscal aid, known as the Coronavirus Aid, Relief, and Economic Security Act, to address current and coming economic difficulties around the country.

That boost will most likely show up later in the year. Based on past stimulus and aid efforts, we expect a fiscal boost of 3.2% in 2020 and 1.7% in 2021, with the single largest impact occurring late in the fourth quarter of 2020 and early in 2021.

Inside that aid package, there is \$425 billion committed to provide a backstop for Federal Reserve lending commitments, which the central bank is widely expected to leverage up to \$4.25 trillion in lending facilities.

One of those lending facilities that we expect to be set up in the coming days will be a trillion-dollar Main Street Lending Program, which will target small and midsize enterprises. This essentially is a middle market lending program that intends to ring fence the real economy during what will be the worst phases of the crisis.

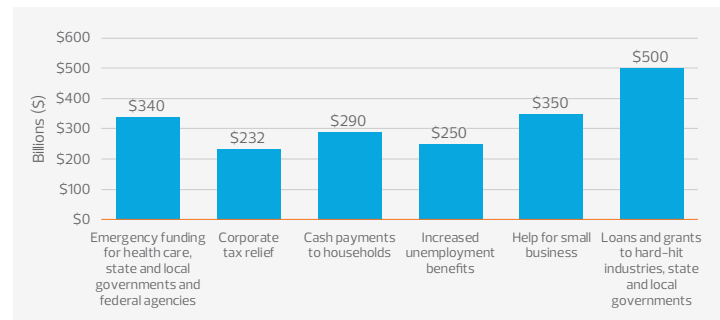
THIS ESSENTIALLY IS A MIDDLE MARKET LENDING PROGRAM THAT INTENDS TO RING FENCE THE REAL ECONOMY DURING WHAT WILL BE THE WORST PHASES OF THE CRISIS.

Around the world, G-7 finance ministers and central bankers are engaged in concerted and coordinated action on the fiscal and monetary fronts. Central banks with the most policy leeway—the United States, Canada and England—promptly responded by cutting their policy rates by an extraordinary half-percentage point, with the Fed following up with another 100 basis-point cut to the zero lower bound in a concerted effort as the emergency unfolded.

The G-7 leaders appeared to accede to the necessity for both fiscal and monetary responses to the virus. As [their transcript](#) said: “Alongside strengthening efforts to expand health services, G-7 finance ministers are ready to take actions, including fiscal measures where appropriate, to aid in the response to the virus and support the economy during this phase.” And this is what occurred.

Of the \$2.2 trillion in fiscal firepower committed to addressing the crisis, \$340 billion will go to emergency funding for health care, and state and local governments;

Major areas of fiscal relief package

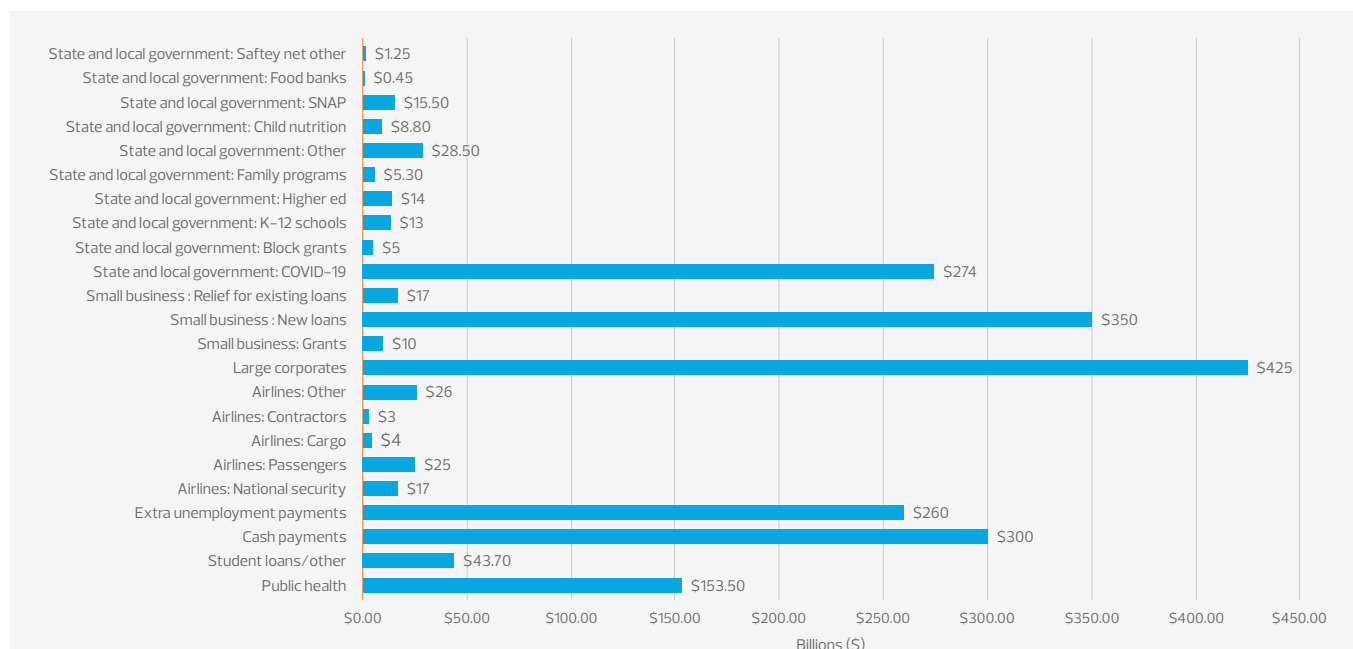


Source: U.S. Congress; RSM US LLP

\$290 billion for cash payments to households; \$250 billion for increased unemployment benefits; \$232 billion in corporate tax relief; and \$500 billion in assistance for hard-hit industries. Inside the \$250 billion in increased unemployment insurance is the much talked about four months of unemployment benefits at \$600 per week.

Most important, Congress committed roughly \$350 billion for new loans for small businesses and an additional \$10 billion for grants and \$17 billion in loan forgiveness.

Fiscal aid package: Selected



Source: U.S. Congress; RSM US LLP

POLICY RESPONSES (CONT.)

In total, the federal government has committed \$2.39 trillion in aid that includes hard cash backstops that will likely result in \$4.25 trillion in liquidity and loan facilities on the part of the central bank. The total aid package so far is equal to 12.4% of GDP. Given the size of the employment shock and the resulting demand shock that is working its way through the economy, we expect there will be other rounds of fiscal aid put forward.

We anticipate that when Congress returns from its break in mid-April, there will be a phase-four package that will target greater than \$100 billion in direct relief for the states and municipalities that will be reeling from the loss of tax revenues and are starting to look at austerity measures to balance budgets.

Ohio, for example, has already begun discussing 20% across-the-board cuts in state fiscal outlays. Austerity measures such as this during the current crisis would tend to intensify the economic damage being inflicted on households and firms. That is exactly the wrong policy path to pursue with the extensive work of the public health community and economic damages to the country still in front of us. This is why that \$100 billion phase-four package will most likely grow as the extent of the damage to domestic household spending and the labor market is ascertained.

Why such a large fiscal response?

The fiscal authorities—Congress and the executive branch—can directly respond to the coronavirus and decide whether to expand health care facilities or to expand the social safety net to maintain income levels. Typically, you would expect a longer process for getting those funds into the system, with politics and ideology creating barriers to the response. But the depression-like shock under way necessitated such a broad, deep and sustained fiscal action.

It is important to note that fiscal responses to the economic losses during the crisis are more of an aid package that is attempting to limit the downside risk around bankruptcies, unemployment and lost growth. Of

equal importance is that as the economy comes out of the shock, there will need to be a round of stimulus that is separate and distinct from the aid package that was recently signed into law. That will need to include both short- and long-term policy support. In the near term, aid to the states, the unemployed and efforts to restart global trade by cutting tariffs back to the levels before the trade war will be on the table.

Over the long term, it would be prudent to look at constructing an infrastructure bank. With the 10-year yield on U.S. government securities trading between 0.70% and 0.80%, it would make sense that the government would allocate \$75 billion over the next five years to create a \$375 billion bank that could then be leveraged up by 10 to 1 to rebuilding the crumbling U.S. infrastructure. Important to note that following the crisis, policymakers do not anticipate that the unemployment rate will fall back to 3.5%. It is highly likely that the domestic unemployment rate will soar well above 10% by midyear.

The burden of adjustment will be borne by uneducated men 25 to 54 years old who will need employment during what will be an elongated and uneven recovery period. Good policy would target rebuilding the country's antiquated infrastructure, thereby creating the conditions that would allow us to avoid the social destabilization that has traditionally followed periods of mass unemployment by men in the cohort.

MIDDLE MARKET INSIGHT

We anticipate that when Congress returns from its break in mid-April, there will be a phase-four package that will target greater than \$100 billion in direct relief for the states and municipalities that will be reeling from the loss of tax revenues and are starting to look at austerity measures to balance budgets.

IT MAY BE UP TO THE MORE AGILE MONETARY AUTHORITY TO REACT TO THE EVOLUTION OF THE ECONOMIC CRISIS.

The monetary response

The monetary authority (the Fed) is independent and most adept at reacting to shocks. It has set up seven lending facilities over the past month and is expected to expand that list in the coming days. It can quickly affect the cost and availability of funds needed to transact business by raising or lowering the overnight rate and by injecting liquidity into money markets that might otherwise freeze up.

Raising and lowering the federal funds policy rate directly affects short-term interest rates at the front end of the yield curve and influences the direction of longer-term interest rates further out along the yield curve. The Fed can also choose to affect the demand and supply of long-dated securities through asset purchases of government bonds (Treasuries and mortgage-backed bonds), further pressuring interest rates at the long end of the yield curve needed for capital investment and supporting economic expansion.

And there will be a call, at some point, to allow the Fed to purchase corporate securities and assets if the virus is not contained and the economy is sinking without control. Thus, it may be up to the more agile monetary authority to react to the evolution of the economic crisis.

According to an analysis published in The Brookings Institution on March 16, 2020, by former Fed Vice Chairman Donald Kohn, the 2020 Fed under Chairman Jerome Powell reacted quickly to the health crisis. [Kohn writes](#) that, having held the world together through the financial crisis of 2007–2009, the Fed was prepared and took the following actions:

- Lowered its target interest rate by a full percentage point nearly to zero, and provided guidance that rates would remain at this level until “it is confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals.” This move followed a 50-basis-point rate cut on March 3.
- Committed to buy \$700 billion of Treasury (\$500 billion) and agency MBS (\$200 billion) securities that was augmented to become what is essentially open-ended, large-scale asset purchases or quantitative easing.
- Lowered the cost of the dollar swaps it does with foreign central banks to facilitate borrowing by foreign banks in dollars.
- Encouraged banks to borrow from the Fed's discount window, where it extends credit to banks backed by a wide range of collateral, by reducing the penalty banks pay above market rates and extending the maturity of the loans.
- Encouraged banks to utilize intraday credit from the Fed, that is, to temporarily overdraw their Fed accounts if required. A reluctance to incur such overdrafts was identified as one factor contributing to the repo market turbulence of last September.
- Encouraged banks to utilize the buffers of liquidity and capital they have built in recent years to extend loans. In effect, the Fed is saying that, as a bank regulator, will not object to, and indeed is encouraging, drawing on liquidity and capital resources as banks meet the elevated credit needs of their household and business customers.
- Reduced banks' reserve requirements to zero. They were already very low and served no purpose in the “ample reserves” monetary policy regime now being implemented.

These actions are transmitted to the real economy via altering financial conditions, with lower interest rates making a more accommodative environment for investing.

It will undoubtedly be argued that the Fed did too little too late, and some will blame the equity market crash on the Fed keeping rates too high. And the Fed will be blamed for exhausting its tools and its effectiveness in one fell swoop. But those criticisms go along with being a central banker. And in our estimation, the Fed has moved in a far swifter fashion and at more depth than during the Bernanke era. ■



COMMERCIAL PAPER FUNDING FACILITY CREATED TO EASE CREDIT STRESS

BY JOSEPH BRUSUELAS

THE U.S. TREASURY on March 17 granted the Federal Reserve 13(3) authority, under the Dodd-Frank Act that permits the central bank to take steps under exigent and unusual circumstances, to stabilize financial markets and the economy.

Treasury stepped forward with a \$10 billion backstop to fund a Commercial Paper Funding Facility to restart the commercial paper market, the market for short-term unsecured promissory notes issued by companies. The policy objective is to support a wide range of economic activity, supplying credit and funding for auto loans and mortgages, as well as liquidity to meet the operational needs of a range of companies.

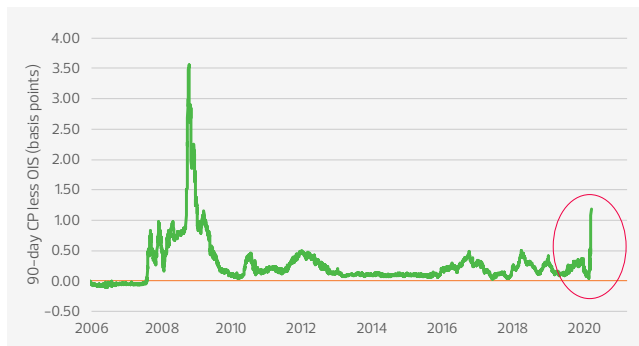
More importantly, the goal is to prevent a larger catastrophe that could include soaring bankruptcies, unemployment and underemployment. While we are

encouraged by this policy step, the Treasury will need to step up with other funds and bridge loans to firms that do not meet the A1 top-rated paper that is required by the Fed act.

The commercial paper market is typically based on an unsecured, short-term debenture issued by a corporation to finance payrolls, accounts payable, inventories and short-term liabilities. The CPFF will address stress in credit markets that had built up to the point where by March 17 the commercial paper was essentially frozen. The primary policy goal in constructing the CPFF is to provide bridge financing to firms experiencing transitory dips in revenue linked to the public health emergency associated with the COVID-19 virus.

BY ENSURING THE SMOOTH FUNCTIONING OF THE COMMERCIAL PAPER MARKET, PARTICULARLY IN TIMES OF STRAIN, THE FEDERAL RESERVE IS PROVIDING CREDIT THAT WILL SUPPORT FAMILIES, BUSINESSES AND JOBS ACROSS THE ECONOMY.

Commercial paper less overnight index swap spread



Wide range of federal funding is required

During the 2007–2010 financial crisis, the Fed created the CPFF following the collapse of Lehman Brothers, the bailout of AIG and the freezing up of the global credit market. The CPFF was funded through a special purpose vehicle that purchased three-month unsecured and asset-backed commercial paper for eligible firms. The Fed took a similar step this year on March 17.

How it works

The New York Fed will purchase from eligible issuers three-month U.S. dollar-denominated commercial paper through the New York Fed's primary dealers. Eligible issuers are U.S. issuers of commercial paper, including

U.S. issuers with a foreign parent company. The SPV will only purchase U.S. dollar-denominated commercial paper (including asset-backed commercial paper that is rated at least A-1/P-1/F-1 by a major nationally recognized statistical rating organization and, if rated by multiple major NRSROs, is rated at least A-1/P-1/F-1 by two or more major NRSROs, in each case subject to review by the Fed.

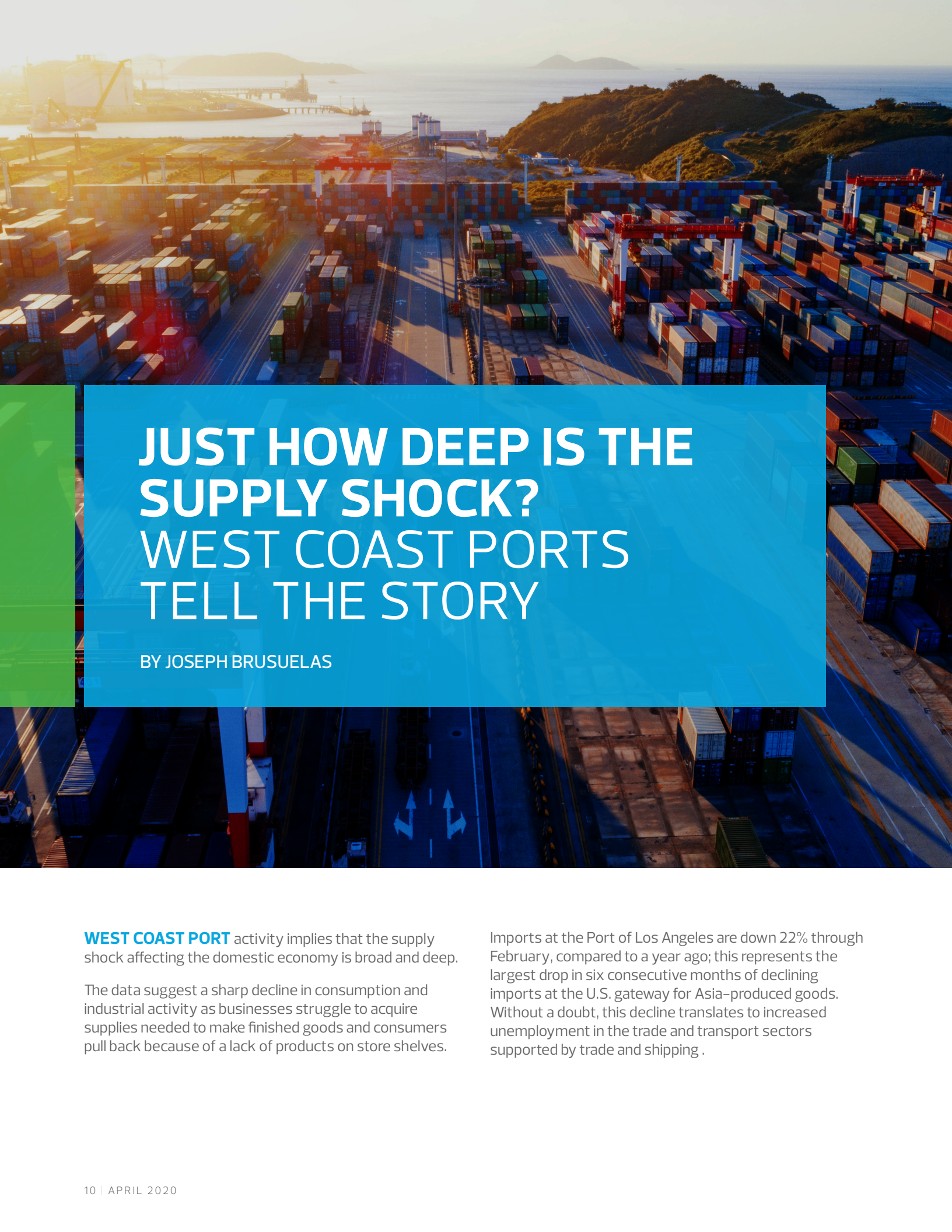
The maximum amount of a single issuer's commercial paper the SPV may own at any time will be the greatest amount of U.S. dollar-denominated commercial paper the issuer had outstanding on any day between March 16, 2019, and March 16, 2020. The SPV will not purchase additional commercial paper from an issuer whose total commercial paper outstanding to all investors (including the SPV) equals or exceeds the issuer's limit.

Pricing will be based on the then-current three-month OIS rate plus 200 basis points. At the time of its registration to use the CPFF, each issuer must pay a facility fee equal to 10 basis points of the maximum amount of its commercial paper the SPV may own. The termination date will be March 17, 2021.

By ensuring the smooth functioning of the commercial paper market, particularly in times of strain, the Fed is providing credit that will support families, businesses and jobs across the economy. ■

MIDDLE MARKET INSIGHT

The CPFF is just one of many liquidity and lending facilities available to small and midsize enterprises that the monetary and fiscal authorities will need to construct and utilize to prevent a collapse of the economy. Moreover, the federal government will quickly need to put into place a massive fiscal stimulus program equal to roughly 2% of gross domestic product that targets households and firms to prevent a complete shutdown of the domestic economy. In our estimation, a so-called "phase three stimulus" is likely a precursor to what will be a multitrillion-dollar effort to stabilize the economy before the risk of the coronavirus has passed.



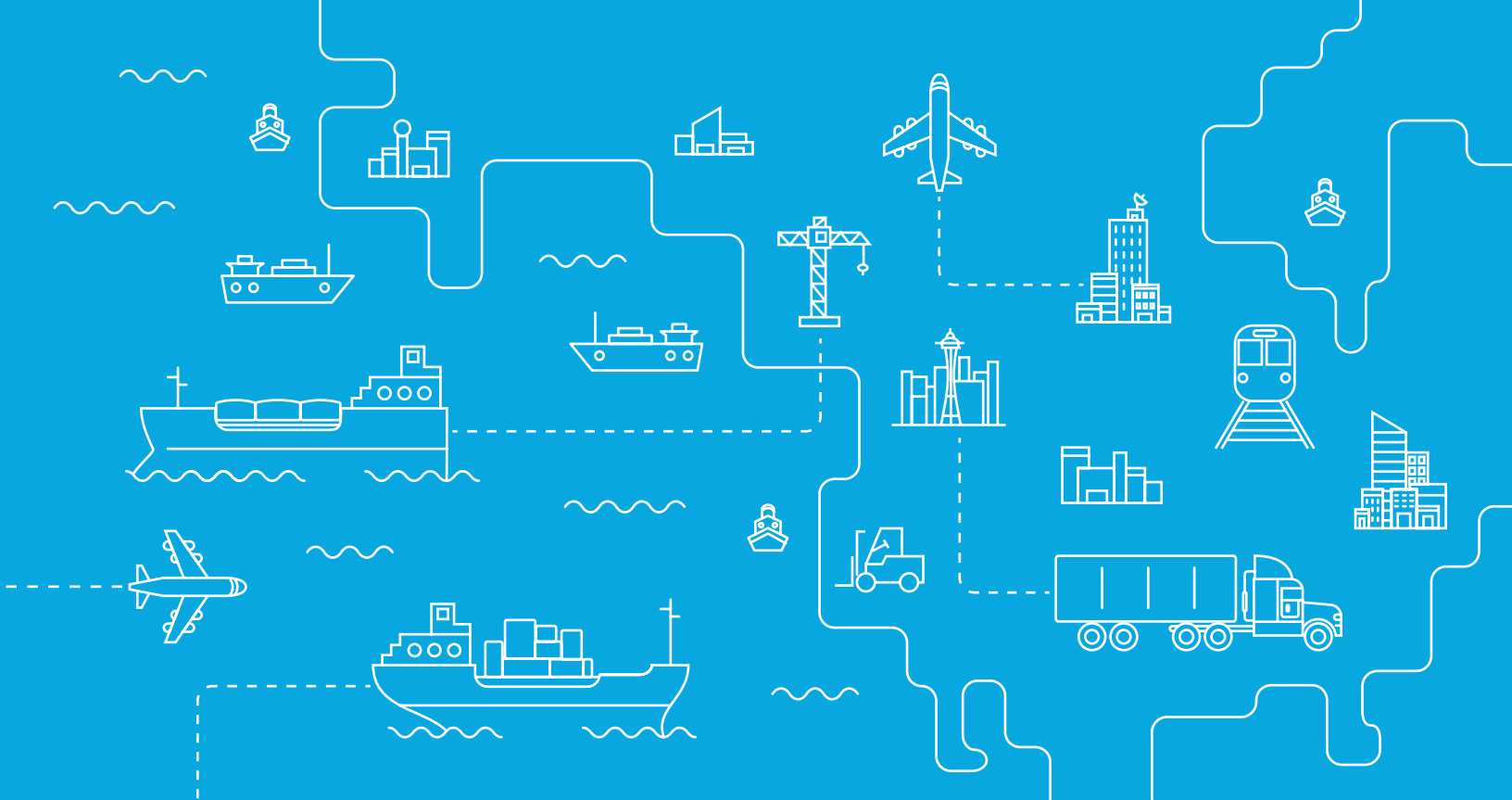
JUST HOW DEEP IS THE SUPPLY SHOCK? WEST COAST PORTS TELL THE STORY

BY JOSEPH BRUSUELAS

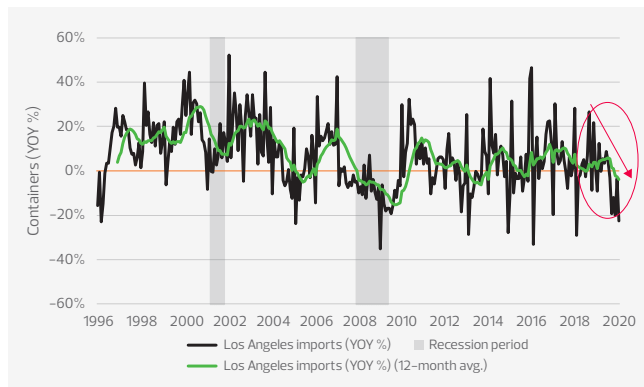
WEST COAST PORT activity implies that the supply shock affecting the domestic economy is broad and deep.

The data suggest a sharp decline in consumption and industrial activity as businesses struggle to acquire supplies needed to make finished goods and consumers pull back because of a lack of products on store shelves.

Imports at the Port of Los Angeles are down 22% through February, compared to a year ago; this represents the largest drop in six consecutive months of declining imports at the U.S. gateway for Asia-produced goods. Without a doubt, this decline translates to increased unemployment in the trade and transport sectors supported by trade and shipping.



Port of Los Angeles imports (YEARLY GROWTH RATE)



Source: Bloomberg; RSM US LLP

L.A. is not alone. Import activity (measured by the decline in shipping containers loaded with imports and exports) at all West Coast seaports is in decline, initially as a result of the U.S.-China trade war, and now as the coronavirus slows production of our Asian trading partners.

The drop in imports implies a continuation of the supply shock facing U.S. consumers once their panic buying subsides. The lack of imports from Asia will make it even more difficult to restock empty shelves once inventories are exhausted.

And with income streams threatened by business closings and consumers sheltering in place, we expect an eventual drop in consumer spending on nondurables, to be followed by a decline in spending on durable goods.

Though not a perfect predictor of GDP growth, the decline in West Coast port activity since 2017 would suggest a further slowdown in overall U.S. economic growth. ■

West Coast port activity and U.S. real GDP growth (YEARLY GROWTH OF LOADED EXPORT AND IMPORT CONTAINERS AT PACIFIC SEAPORTS)



Source: Bloomberg; RSM US LLP

CORONAVIRUS IMPACT ON MIDDLE MARKET BUSINESSES

HOW IS THE VIRUS OUTBREAK AFFECTING BUSINESSES ACROSS INDUSTRIES? OUR SENIOR ANALYSTS EXPLORED.



CONSUMER PRODUCTS



How middle market retailers can position themselves to survive both coronavirus and Amazon

BY CHRISTOPHER SHAKER

JUST AS MIDDLE MARKET retailers have been scrambling to figure out how they would handle the fallout from the coronavirus pandemic and maintain their businesses, the industry's behemoth, Amazon, weighed in with its own plan. Usually, these announcements carry ominous news for small and midsize retailers. But this announcement from Amazon was different, and in fact it carried a ray of hope—that is, if smaller retailers remain nimble and act quickly.

Amazon's announcement included three critical components:

- Hire 100,000 additional workers to keep up with increased demand
- Boost current employee wages by \$2 per hour
- Suspend inbound shipments of nonessential products

It's in this third component where middle market retailers might find some opportunity. That's because the suspension of nonessential products through at least early April will leave the door open for other retailers that have the flexibility to focus on the categories that shoppers will not be able to find on Amazon.

How to do it

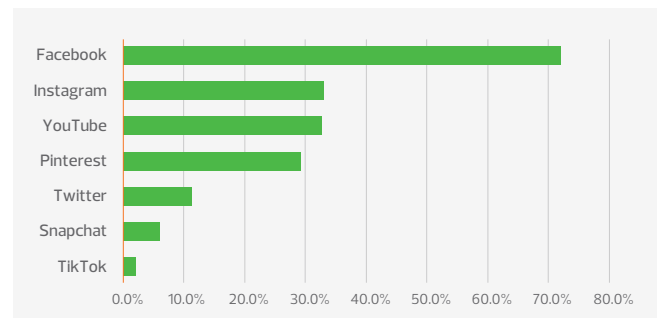
If Amazon does not extend the suspension, the time frame to execute it is very short. But this same small window is part of a larger critical time period in which consumers will be sheltered in their homes as the country tries to slow the spread of COVID-19. Retailers that act quickly may be able to capture some additional sales.

Here are two areas to focus on:

- Identify inventory items that are not available on Amazon: Once that is done, consider a marketing campaign that includes targeted discounts and promotions for those items.

- Select the right advertising channel: With the increase in overall internet usage, online advertising and email campaigns are two clear possibilities. There is also a third, and perhaps more powerful, option to consider: social media.

U.S. social media shoppers: Platform used for shopping



Source: Coresight Research

To be sure, the unique customer demographic of each retailer will dictate the level to which social media can be used, but for many it's an option that should be considered.

The concept of omnichannel has evolved in the retail ecosystem to include channels beyond just brick and mortar, and online. The use of platforms such as Facebook and Instagram for both shopping as well as purchasing has been growing rapidly.

That trend will most likely accelerate with hundreds of millions of Americans confined to their homes. Those retailers that can reach customers through social media with targeted advertisements for items that aren't available on Amazon create the opportunity to capture sales. Going a step further, discounting a complementary household staple with an underrepresented item on the Amazon marketplace may help to both expand the basket, as well as to steal a sale from Amazon.

THE TAKEAWAY

This strategy, if properly executed, will not only generate sales in the short term, but will also strengthen the overall brand loyalty for that customer—and that will deliver value beyond the current crisis.

FINANCE: PRIVATE EQUITY



As coronavirus spreads, private equity contracts even as it prepares for a rebound

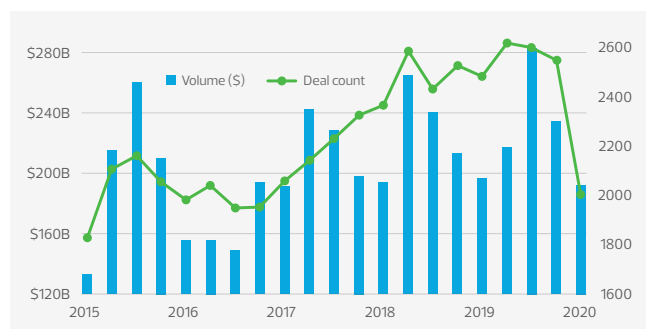
BY KENNEDY CHINYAMUTANGIRA AND ANTHONY DECANDIDO

AS THE U.S. FINANCIAL system and broader economy swoon from fear of the damage that the coronavirus will leave in its wake, private equity deal flow will feel the pinch. Although data for the first quarter of 2020 is not yet complete, indications are that deal flow has slowed based on the dollar value, deal count and average premiums paid in public deals closed by private equity buyout firms.

But it is important that private equity firms or financial service firms that support them retain a robust reserve capacity to adequately meet demand that will come on the other side of the crisis. It is likely that the private equity ecosystem will experience a V-shaped recovery following the sharp, albeit transitory, shock that the economy is absorbing.

While the recently signed fiscal stimulus may mitigate the impact of the shock somewhat, those efforts are likely to be a day late and a dollar short. For this reason, private equity firms need to prepare for what will be a time of unprecedented value offerings in the market.

Private equity deal flow



Source: Bloomberg; RSM US LLP

In the meantime, though, the slowdown is occurring. Beyond public deals, data on private deals (where neither target nor acquirer is public) is slower to be reported, and developments over the past few weeks point to a slowdown there as well.

Contributing to the slowdown are the restrictions that many industries are facing—limits on nonessential travel and employees being told to work from home as social distancing has become a priority. This limitation in interaction will most likely hamper deal closings as the auction, due diligence and negotiation process is disrupted for deals that were already in the pipeline.

It does not look good for new deals entering the pipeline, either. Confidence is dissipating quickly as financial markets collapse and financial conditions tighten. Since the last week of February, financial markets have descended into outright panic, with U.S. equity markets entering bear market territory for the first time in over a decade.

Private equity managers are messaging portfolio companies to access credit to prevent any liquidity shortfalls amid mounting stress in the markets. Supply shocks, emergency stockpiling, interrupted spending patterns, dramatic swings in commodity prices and lost income have the potential to send consumer prices on a whipsaw trajectory over the next several months.

Certain industries like hospitality and energy require the greatest focus of private equity managers and are most susceptible to loss. With this, certain value-creating projects, like systems implementations, recruiting and digital initiatives have been put on hold as managers have reprioritized their operating agendas for survival.

The coronavirus pandemic has begun forcing deal-makers to rethink how to manage risk in mergers and acquisitions. Appetite for deal-making will continue to slow as both buyers and sellers adopt a wait-and-see approach. Market dislocations such as these present both risks and opportunities. Private equity firms will need to monitor both sides to capture potential gains and protect against loss.

Opportunities to position for the future

Lower valuations: The tightening financial conditions should keep valuations contained and present potential acquisitions at attractive prices. When interest rates decline, so do the prices for risk assets. Private equity firms will need to continue to take calculated risks on good companies if bargains are there for the taking. The sectors that undergo the greatest dislocation will also be the ones

with the most long-term opportunity. And with record amounts of dry powder available, many funds will be well-positioned to capitalize on struggling companies seeking strategic partnerships.

Data and intelligence: Private equity firms in recent years have looked to alternative sources of data to help find new opportunities and manage their operations. The current economic dislocation will put these models to the test. We would recommend carefully studying data during this period, in real time and in greater depth retrospectively, to better understand changing customer behaviors and preferences and challenge existing operating models. Private equity firms will need to figure out how to creatively leverage the results that the current stress presents in order to improve the businesses in their portfolios and to inform investment decisions in the future.

Credit and interest rates: Credit markets have tightened and central banks worldwide have responded by easing monetary policy. While lending will slow in the short-run, it will hopefully pick up at some point as coordinated monetary and fiscal policy actions work through the system. The low interest rate conditions, however, seem likely to stay. The yield on the 10-year Treasury bill is below 1% and is expected to stay there for some time. Private equity will need to take advantage of the low rates at the earliest opportunity when credit markets loosen up to optimize financing of deals and portfolio company operations.

Risks to be considered

Liquidity management: As credit spreads widen, those businesses that are highly leveraged with floating rate debt or with maturities coming soon will feel the squeeze. Private equity firms will need to act to avoid a credit crisis that may disrupt operations or threaten survival for their portfolio holdings. Understanding or implementing contingency funding strategies is crucial. This may be in the form of follow-on investment from existing fund commitments, drawing on all available lines of credit, and exploring alternative sources of financing such as other asset managers, specialty finance companies or government funding programs.

Contractual obligations: Unusual circumstances that may arise as economic conditions deteriorate could trigger clauses in contracts that may have seemed benign or inconsequential in the past. Firms should take stock of key agreements, particularly debt arrangements and deal documents, both at the fund level and at the portfolio company level, for clauses that impose certain

obligations as a result of unexpected failures to perform. These include covenants, material adverse change, force majeure, indemnity and liability clauses that may be tripped up by any disruptions. Understanding these exposures and moving early toward resolution may alleviate the effect of these contracts.

Cybersecurity threats: In periods of disruption in the economy, security and privacy concerns may not be top of mind for business managers. But that is the environment in which criminals seek to exploit vulnerabilities. It will be essential for private equity firms and their portfolio companies to remain vigilant and continue to shore up defenses as attacks may accelerate during the coming months.

Changes in the political environment: A black swan event like the coronavirus will inevitably have political ramifications. Depending on the outcome of the election, private equity firms could be faced with significant tax policy reform that could include higher tax rates on personal income and capital gains, and, possibly a wealth tax.

Emergence of alternative asset classes: Private equity has become the preferred asset class in asset management as it has outperformed the S&P 500 index by a compounded annual rate of 5% since 2000. At the same time, hedge fund managers have had more dollars redeemed than contributed and many have questioned the long-term sustainability of the asset class. With the recent panic in the stock market, a notable change occurred. For the first time since the Great Recession, the Global Hedge Fund Index outperformed the S&P 500 index. If equity markets continue to drop quickly, investors may reallocate capital to hedge funds that could offer better downside risk protection.

THE TAKEAWAY

Private equity deal flow will take a knock from the effects of coronavirus. Even if the full extent of a slowdown caused by the pandemic is currently not clear, the disruption that will take place over the next two quarters will present a complicated environment with both risk and opportunity. These will need to be carefully balanced for a firm to emerge stronger from any downturn—however long it may be—and be ready to take advantage when the deal-making environment turns the corner.



HEALTH CARE

Coronavirus, rural health care and the role of telemedicine

BY RICK KES

AS THE CORONAVIRUS has continued to spread throughout the United States, its impact has been felt mostly in populated areas. At the same time, states with a more rural demographic have experienced slower rates of infection. Logically, it would make sense that more densely populated areas would have higher risks of community spread. But that doesn't mean rural areas are without risk. As rural communities experience outbreaks, they are more vulnerable because they lack the necessary medical facilities to treat an expanding number of patients.

Indeed, the shortage of medical services in rural areas has become more acute in recent years. Since 2005, 168 hospitals in rural areas have closed, according to the University of North Carolina's Cecil G. Sheps Center for Health Services Research. And that pace has been accelerating, with 25 more closing between Jan. 1, 2019, and February 2020.

When a hospital closes in a rural community, the effect goes beyond residents needing to drive further to a hospital to receive care. It can have a material effect on their local economy. But the coronavirus represents a potentially significant new challenge, with nearly 20% of the American population living in rural areas, according to the U.S. Census Bureau.

Not only do rural hospitals often lack the resources of larger, big-city medical centers, like ventilators, intensive care units and large emergency rooms that can handle more patients, but rural hospitals also often do not have the medical workers with the training to handle patients with more specialized needs.

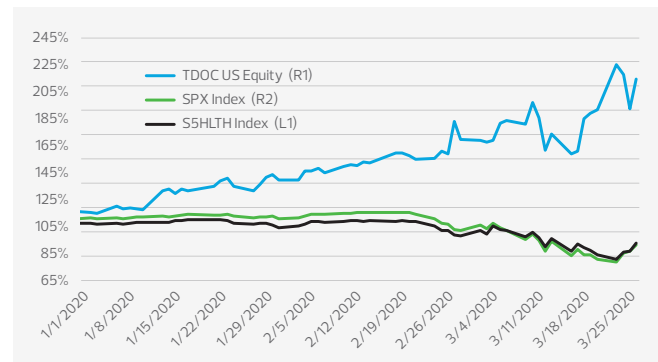
Enter virtual medicine

With advancements in virtually delivered health care and screening, the treatment of milder cases could perhaps be managed virtually. Virtual health companies like the publicly traded Teladoc discuss services they offer to individuals who believe they may have the disease.

Patients who have symptoms can limit their exposure to other potentially infected people by not going into a physical setting while at the same time reducing the burden on the care delivery system. Additionally, digital health tools can be delivered anywhere there is internet access (of course, this is potentially an additional issue for rural areas).

As a result of several factors, including, the March 17 announcement from the Centers for Medicare and Medicaid Services that they will expand coverage to a wider range of services delivered through telemedicine, the rapid spread of the virus and the ability for virtual health providers to provide services to potentially both infected people as well as treat people who do not want to come to a physical setting due to social distancing protocols, Teladoc's shares have outperformed the S&P 500 and the S&P 500 Health Care Sector significantly.

TDOC's performance



Source: Bloomberg;

THE TAKEAWAY

Despite its advantages, virtual medicine may not be the cure-all for the challenges hospitals are currently facing. To start, many hospitals are focusing on educating their communities, distributing educational material and content regarding hand-washing techniques, and the importance of following social distancing protocols. Additionally, hospitals are focusing on preparedness. Even if many rural hospitals have yet to be dramatically affected, they are working with government agencies to determine their plans if the outbreak extends into their communities. In the end, health officials understand, prevention and preparedness are the best medicine.



LIFE SCIENCES

Coronavirus disrupts the pipeline for new drugs and medical devices

BY ADAM LOHR

ON MARCH 10, a day before the World Health Organization declared the coronavirus outbreak a pandemic, the Food and Drug Administration announced that it was postponing foreign inspections through April. This increases the risk that some drug and device companies will run into issues obtaining approval for their products. FDA Commissioner Stephen Hahn stated that inspections deemed "mission critical" would be decided on a case-by-case basis.

While the FDA will be using other means of sharing information between foreign governments and inspectors to keep monitoring active, the more pronounced disruption would come for product applications, which require on-site inspections.

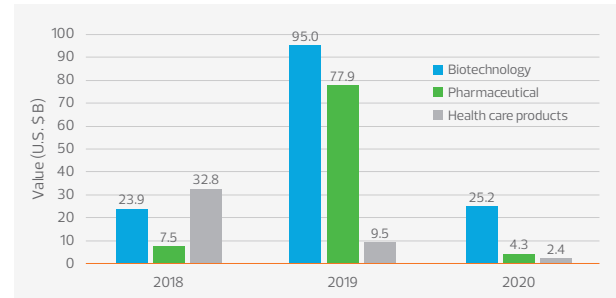
"We are aware of how this action may impact other FDA responsibilities, including product application reviews," the agency said in a statement. "We will be vigilant and monitor the situation very closely and will try to mitigate potential impacts from this outbreak in lockstep with the whole of the federal government. We stand ready to resume foreign inspections as soon as feasible."

In our opinion, any company that has an application pending must remain very active in moving the process forward. And even if a company is planning to submit an application in 2020, it needs to start thinking strategically about when to file or when to hit the pause button.

Given that the majority of new therapy and product development comes from startups and middle market companies (which are often acquired by larger pharmaceutical companies), this could have a significant impact on the life science ecosystem if the travel bans continue.

M&A activity in biotech, pharmaceutical and health care products

(DECEMBER 1 – MARCH 1 FOR THE PAST THREE YEARS)

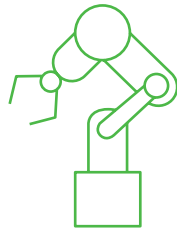


Source: Bloomberg

It's important to keep in mind how expensive it is to bring a product to market and that most life sciences companies applying for approval are in a pre-revenue stage. If the development milestones are interrupted, and investors become increasingly risk-averse, it could have major financing and commercialization process implications.

THE TAKEAWAY

The three months ending February 2020 had the fewest number of private equity and venture capital investments in the life sciences sector since 2011, according to PitchBook. While the total amount invested has continued to increase over the past several years, the number of companies securing those investments is decreasing, a point that should not be ignored while seeking financing.



MANUFACTURING

March Federal Reserve data signals more challenges ahead for manufacturers

BY MEGAN HICKS

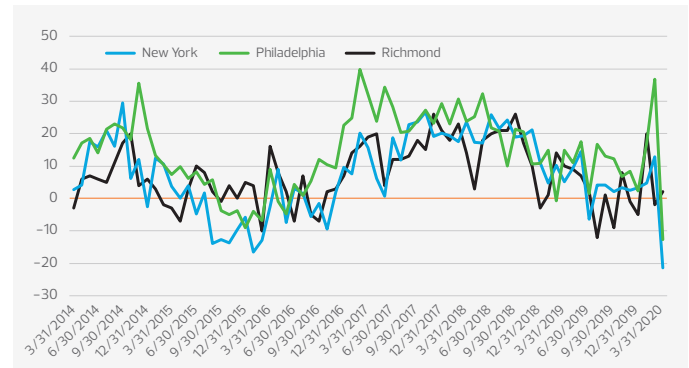
SURVEY DATA RELEASED in March from the Fed's New York and Philadelphia districts shows the greatest manufacturing index drop ever recorded in those regions, with overall readings well below earlier estimates and in negative territory. The Federal Reserve Bank of Richmond's survey of manufacturing activity remained close to zero, rising slightly from February into positive territory. Negative readings indicate contraction.

Given the staggering economic impact of factory slowdowns and shutdowns resulting from the growing number of cases of COVID-19 in markets around the world, these March results do not come as a complete surprise. At press time, the final two Fed districts will report data in the coming days.

Lower employee counts, weak business conditions

Consistent themes across several regions included decreased number of employees and a decline in future business conditions. Richmond reported the greatest decline in employees and the most negative reading. New York reported the lowest reading in future business conditions since 2009 and Richmond fell into negative territory. Manufacturers in all regions anticipate weaker business conditions in the coming months including decreased new orders and shipments and persistent labor challenges.

Regional Fed manufacturing indices



Source: Bloomberg; RSM US LLP

About the surveys

Regional manufacturing surveys measure economic health and are used to gauge the overall manufacturing health of the nation. Monthly results provide visibility into business and economic activity for the manufacturing sector, which accounts for approximately 11% of U.S. GDP, according to the Bureau of Economic Analysis. The geographies covered by each Fed district are as follows:

- New York – New York State, 12 northern counties of New Jersey, Fairfield County in Connecticut, Puerto Rico and the U.S. Virgin Islands
- Philadelphia – Eastern Pennsylvania, southern New Jersey and Delaware
- Richmond – Ohio, western Pennsylvania, the northern panhandle of West Virginia and eastern Kentucky
- Kansas City – Colorado, Kansas, Nebraska, Oklahoma, Wyoming, northern New Mexico and Western Missouri
- Dallas – Texas, northern Louisiana and southern New Mexico

THE TAKEAWAY

Weak economic and business activity indicated by manufacturers will be reflected in the second quarter GDP results. Regional data signals contraction in two of the three regions reporting, but the length and severity of contraction is still unknown. Manufacturers should identify ways to adapt their business in these uncertain times.



REAL ESTATE

Housing was set to soar: Then came coronavirus

BY TROY MERKEL

IN JANUARY, the housing market was poised to take off. Home builders had changed strategy to focus on entry-level homes to serve a growing need in the market. Permits and housing starts were at 10-year highs. Wage growth and unemployment were strong. Interest rates were down to 3.5%, bringing the market back to a level last seen in 2013.

It all led to a National Association of Home Builders' Confidence Index of 75 in January, up from 58 the year before. The growing confidence was supported when home buyer traffic index scores rose to levels not seen since 1998, as millennials finally seemed poised to become first-time homeowners after years of waiting.

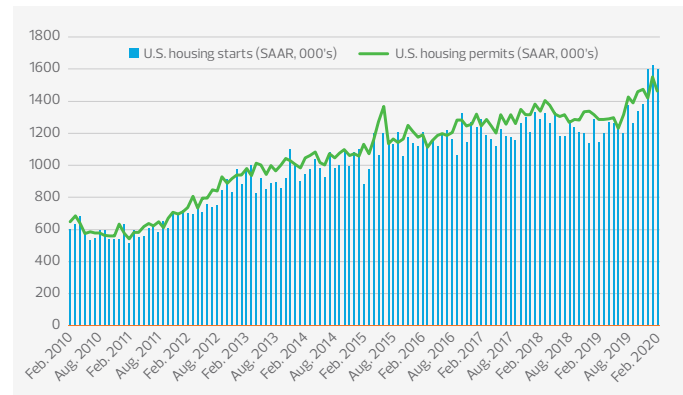
Now, it seems as if those days were a lifetime ago. In the weeks since, the coronavirus has become a pandemic. Equity markets have plummeted. U.S. Treasuries, the 10-year being a leading indicator of the 30-year mortgage rate, whipsawed early in the quarter, at one point hitting an unheard of 0.32%. The MBA Mortgage Applications Survey Purchase Index is a signal of what the housing market can expect in the coming months as demand falls precipitously to 280.7 reported on March 6 to 211.7 as reported on March 27.

Housing data typically lags behind the equity and bond markets, but as the February numbers indicate, not even housing is immune to the coronavirus. Housing starts fell 1.5%, to a seasonally adjusted annual rate of 1,599,000, which is less than anticipated as forecasters projected a 4.3% decline.

It should be noted that the January figure of 1,624,000 represented a 13-year high and was likely to level off. Housing permits, a more volatile figure but also a leading indicator, fell by 5.5% in February after a 9.2% increase in January. This was a steeper decline than the 3.2% drop expected by forecasters.

Forecasters incorrectly assumed that the impact of the coronavirus would be short-lived. But much like the virus itself, the incubation period for negative economic news will be delayed and the havoc unleashed on the public health and economy has yet to peak.

U.S. housing starts and U.S. housing permits



Source: Bloomberg; U.S. Census

April numbers may be worse as the virus has spread and workers are asked to stay home. Several cities may follow Boston's early lead in temporarily suspending construction. Most contractors lack the cash surplus to carry payroll for workers on the sideline, and the industry is often one of the first to lay off employees when work slows. Layoffs will happen and the construction industry will not be immune.

THE TAKEAWAY

All these factors are setting the industry up for a challenging first half of 2020 while it bears the full economic impact of the virus and looks to recover to what only weeks ago looked like a healthy housing market.

TECHNOLOGY



Coronavirus and the global technology supply chain

BY VICTOR KAO, KURT SHENK AND DAVIS NORDELL

TO UNDERSTAND WHY the coronavirus has had such a profound impact on global supply chains and the world economy, look no further than how reliant technology companies have become on Chinese manufacturers.

Nearly 20 years ago, during the SARS epidemic, China's economy was much different and less interconnected to the world economy, supplying mainly textiles, clothing and shoes on a global basis. Today, a technologically advanced China is an economic powerhouse, producing chips, semiconductors, smartphones and hardware that account for 21% of global IT hardware expenditures. And the impact of the coronavirus has consequently become much more pronounced.

Smartphones, chips and memory

Apple is the most prominent example of technology companies' dependence on China's economy and manufacturing facilities. The discussion around the coronavirus has been woven throughout recent Apple filings, more than any other company. Supply in memory chips, DRAM (dynamic RAM chips used in PCs, work stations and servers) and NAND storage (solid state flash memory) is expected to decline because of factory shutdowns.

In the past, Apple, along with other smartphone and hardware companies, gained significant advantages in scale and a reduction in the cost of goods by concentrating its manufacturing in China. China also became a major market for Apple, accounting for nearly 17% of its revenue.

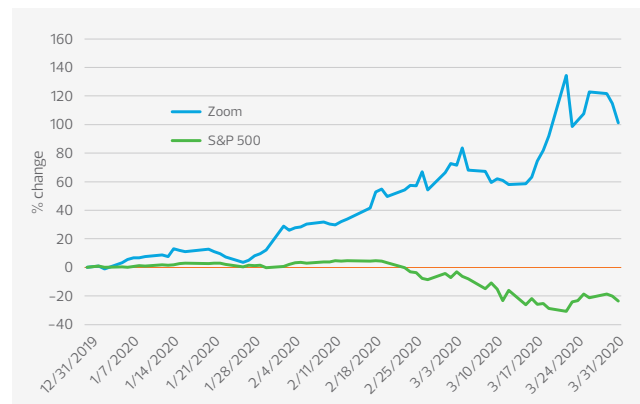
But the coronavirus has underscored what many analysts have been saying about Apple—that it needs to decrease its reliance on China. Apple took the rare step in announcing cuts within its revenue forecast because of supply chain constraints and the temporary closure of its 42 stores in China in February.

Not only has the epidemic already cost Apple an estimated \$200 million in lost sales, but factory shutdowns by its major supplier Foxconn will also disrupt Apple's global supply chain. Foxconn's largest iPhone assembly site is 300 miles from Wuhan, the epicenter of the coronavirus, and ongoing production delays are expected to reduce iPhone shipments by 5% to 10% in the quarter. In addition, factory shutdowns and supply chain disruptions are expected to delay the release of the highly anticipated iPhone 12.

The evolving workplace

Travel restrictions and canceled conferences are creating large strains on the overall travel and hospitality sectors. But with more people working from home, companies that focus on this shift are benefiting, particularly in cloud infrastructure.

Zoom Video Communications vs. S&P 500



Source: Bloomberg; RSM US LLP

A good example is Zoom, the videoconferencing unicorn whose stock has nearly doubled since the spread of the coronavirus. Zoom had an impressive initial public offering in April 2019, opening at \$36 per share and settling in at \$62 on that day, and has since crossed \$100 per share.

Diversify, diversify

Along with allowing employees to work from home, companies also need to rethink their supply chains. Not unlike managing a 401k financial portfolio, they need to diversify their risks—in this case, by spreading their supply chain across several countries.

This was already happening before the virus outbreak. The imposition of tariffs against Chinese exports in 2018 spurred many technology companies to look beyond China for new supply sources, despite the short-term impact on earnings or operations.

Samsung and Ericsson, for example, have already seen benefits by shifting their global supply chains to neighboring countries in Southeast Asia because of escalating tariffs and the trade war. In fact, U.S. trade in goods rose faster with Vietnam than with any of its largest trading partners. Trade with China has fallen most rapidly, contributing to a narrowing trade deficit between the United States and China. The U.S. deficit in goods with China decreased 17.6% in 2019, to \$345.6 billion, its lowest level since 2014.

What are the options?

U.S.-based technology companies should evaluate the costs, risk exposure, broad corporate principles and financial incentives when considering the consolidation or diversification of a supply chain.

Look to automation: Automation and advanced, affordable robotics have enabled countries in both North America and Southeast Asia to close the gap in labor production cost and output significantly and can be a viable option for enterprises looking to diversify supply chains away from China.

Bring it back home: Corporate strategy and a growing focus on environmental, social and governance initiatives, or ESG, have driven some enterprises to consider re-shoring some of their manufacturing back to North America, closer to their customers. Examples of this can be seen across the industry, with companies committing to manufacturing some of their products in the United States. This will enable them to more closely monitor and achieve progress toward both environmental and social metrics.

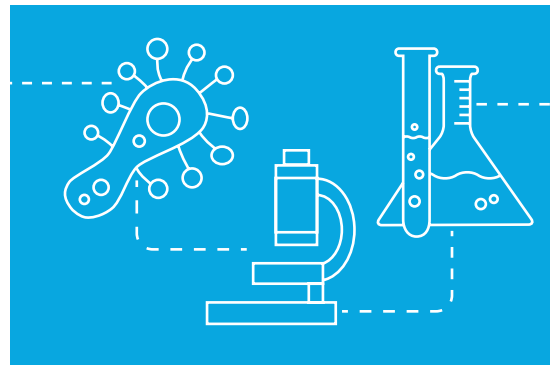
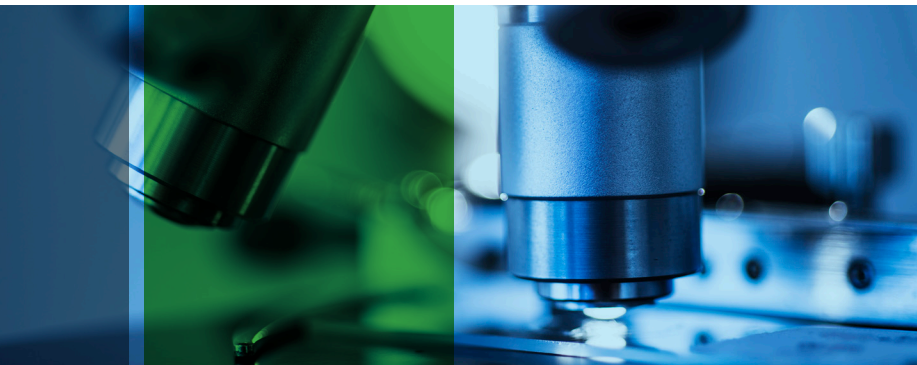
Do it gradually: Making a shift in an established, proven supply chain is not simple; it requires an investment and takes time. When considering shifting or diversifying a supply chain, companies should look for opportunities to either move a percentage of a process or product into a new geography. Over time, companies can evaluate the viability and risk associated with the move, without much impact to output or productivity.

Lift and shift: As an alternative to slowly relocating the supply chain, companies may look to lift and shift the entire supply chain into a new geography. This move may prove to be more costly up front, but it holds the possibility of greater returns as the new supply chain matures. At the same time, it carries greater risk, given the impact that an unsuccessful relocation could have on output.

THE TAKEAWAY

In the end, careful consideration is key with any decision to shift a supply chain. But one thing is certain: Not having a detailed understanding of the risk associated with relying on a sole producer, or the risks involved with dealing with one country or region, could prove to be a costly mistake in a time of heightened global economic uncertainty.

MIDDLE MARKET TREND WATCH



ECONOMIC TRENDS AMID A PANDEMIC

THE HARRIS POLL conducted a mid-March survey to gauge American reaction to the coronavirus outbreak. Questions ranged from opinions on health concerns, support systems and government expectations to thoughts on economic trends, which we've highlighted below.

On average, Americans anticipate it will take over eight months for the markets to recover once the virus is under control.

Nearly eight in 10 (**77%**) fear global recession is inevitable.

55% of individual investors are neither selling nor buying stocks in the current market.

Investors appear to be taking a long-term approach to the market; 60% believe the market will recover from its losses.

Source: With permission by [The Harris Poll](#)

THE TAKEAWAY

Suffice to say, we're in challenging and uncertain times; solutions may be elusive for quite some time. However, there are a few actions middle market businesses can take now to help mitigate disruption and risks, including:

- Evaluate your supply chain and determine if a dependence shift away from China and Southeast Asia to North America is needed.
- Assess how you ship goods and consider alternative transportation strategies.
- Measure your liquidity level to determine how you can weather the virus fallout.
- Stay informed with the latest insights, ideas and countermeasures to minimize the outbreak's negative effects. One way to do that: visit our [Coronavirus Resource Center](#).



Business insights to bolster your response to COVID-19

As middle market businesses like yours respond to the impact the coronavirus pandemic has had within your organizations, it's important for you to stay on top of the evolving issues related to this crisis in order to mitigate risks and plan accordingly.

RSM can help you stay informed with the latest insights, ideas and countermeasures to minimize the outbreak's negative effects, as well as prepare you for future emergency events.

Visit our [Coronavirus Resource Center](#) to learn more, and [register](#) for upcoming webcasts or [view](#) on-demand presentations.

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