Chart of the Week

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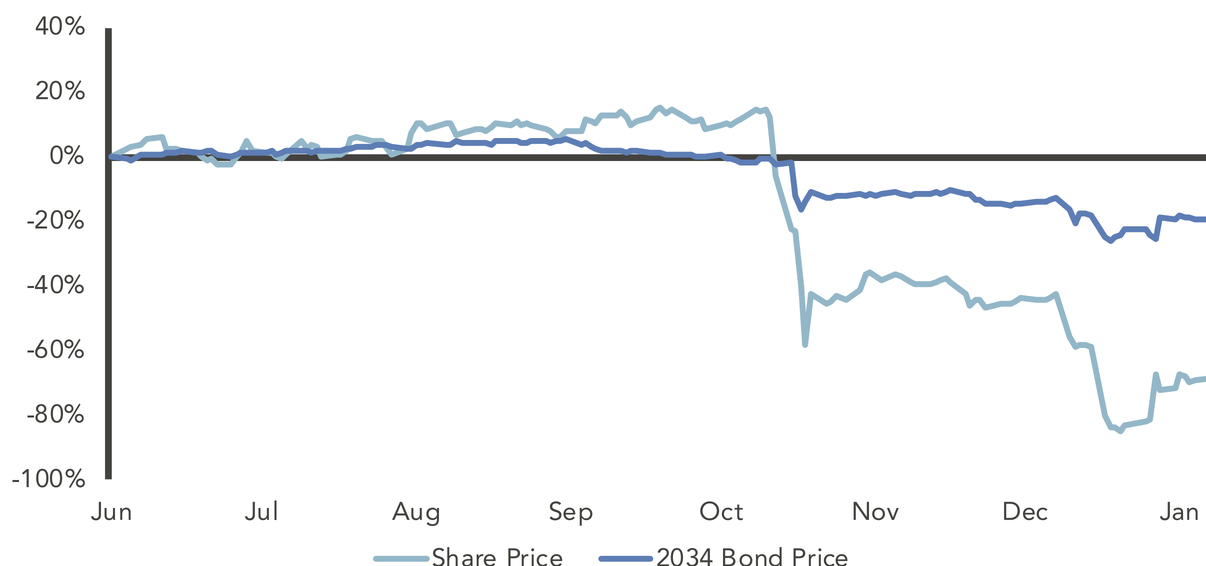
Can the PG&E Bankruptcy Create Profits for Hedge Funds?

JOE MCGUANE, CFA, SENIOR RESEARCH ANALYST, ALTERNATIVES

PG&E's performance during 2018 and into 2019 reflects wildfire liability speculation



Source: FactSet

This week's chart examines the price performance of Pacific Gas and Electric ("PG&E") Corporation's public debt and equity. Because of what they provide, publicly traded utilities have long been considered defensive investments due to their relative stability throughout economic cycles.

In the third quarter of 2018 hedge funds began buying shares of this California public utility on the view that PG&E's liability for 2017 wildfires would be much lower than expected. This buying took place ahead of the deadliest wildfire in California history which many blamed on PG&E electrical lines. PG&E's exposure to wildfire liabilities is heightened by the state's inverse condemnation, a legal standard which holds utilities responsible for all damages caused by their equipment. On January 29th PG&E filed for bankruptcy related to the more than $30 billion in liabilities it faces related to California wildfires in 2017 and 2018.

Many hedge funds that bought both debt and equity of PG&E in the third quarter of last year have seen the equity and debt sell-off over 60% and 18% respectively through January. This price drop has caused some managers to exit their positions. With the company announcing a bankruptcy filing, distressed hedge funds have stepped in to buy up both the equity and debt of the company. Their rationale for doing so is that the payout of the liabilities will be smaller than originally expected and thus both equity and debt prices can recover enough to deliver a profit relative to the currently depressed prices.

PREPARED BY MARQUETTE ASSOCIATES

180 North LaSalle St, Ste 3500, Chicago, Illinois 60601
CHICAGO I BALTIMORE I PHILADELPHIA I ST. LOUIS

PHONE 312-527-5500
WEB marquetteassociates.com

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