Level Four Capital Management

SPECIAL COMMENTARY

WHAT IS DRIVING THE MARKET VOLATILITY?

Investors are once again tackling market volatility, the likes of which we have not seen since December 2018. This of course leads to questions and the search for information and insight to address what is driving this new round of market declines. To that end, let's address some of the key market themes:

> "Fear can take mkt lower, but expect quick recovery when health threat recedes. Esp in US, underlying economy strong, banks well-capped, system not too leveraged. Unlike '08, will avoid systemic damage that cud take years to work thru. Obviously, not ignoring tragic human toll..."
>
> **@LLOYDBLANKFEIN**
> ***Lloyd Blankfein, Senior Chairman***
> ***Goldman Sachs***

COVID-19

The Coronavirus continues to spread globally. And while we have seen the spread of the virus slow in China where it began some two months ago, the reach and speed of the virus continues to cause uncertainty. At the core of this uncertainty is the impact on global growth. In our last *Special Commentary* piece, we addressed the number of active cases versus diagnosed cases. We continue to look to this number as a gauge above and beyond the news headlines which seem to be focused more on grabbing attention than conveying the case for containment or control of the virus. According to www.worldometer.com as of today, March 9th, current active cases are 45,252 versus 111,867 diagnosed cases. That's 62,722 recovered patients.

One of the hardest hit countries outside of China, is Italy. The Italian government continues to do all it can to curb the spread of the virus as they announced a lock-down that will impact about 16 million people in a bid to contain the outbreak. Additionally, all schools and universities in the country will remain shut until March 15th.

Last week we also saw:

a. The CDC lift restrictions on COVID-19 vaccine testing, and

b. President Trump sign a funding bill into law that will allow for $8.3B in U.S. Coronavirus related aid. $3B will go toward developing treatments & $2.2B toward containment.

OIL PRICES

Outside of the Coronavirus, the energy sector is now in the spotlight with oil prices falling sharply on news of a price war. The decline in oil was precipitated after Russia refused to agree to additional production cuts established by OPEC+ as they looked to establish a floor for prices. Brent & crude prices fell 24%, the most since the Gulf War in 1991 as both Saudi Arabia and Russia plan to raise oil output in the coming months. Reports out of the group have signaled that Saudi Arabia could raise output above 10mbpd and will look to accelerate production as high as 12mbpd. Production from the nation has averaged about 9.7-9.8mbpd since March of 2019, while the largest output was capped at just under 11.1mbpd back in November of 2018. Over the long-term, as virus concerns moderate and global growth returns, we would also expect global demand to also re-accelerate, helping the price of oil. Investors will wait to see whether either nation will return to the negotiating table.

For additional information regarding LFCM insight on the energy sector and why we reduced our exposure to the sector last year, please see our *Portfolio Update from Sept 4, 2019.*

INTEREST RATES (MONETARY AND FISCAL POLICY)

The Federal Reserve and counterparts across the globe are working to prop up markets through a number of strategic measures. Market participants continue to price in further rate cuts by the Fed in order to combat global slowing growth and a decline in oil prices. After the most recent 50bps cut on Tuesday last week, investors continue to call for additional cuts as Fed Fund futures are currently pricing in another four cuts by year end, with an implied policy rate of .126. Furthermore, to ensure the funding/repo markets operate properly, the central bank has indicated it will up the amount it offers in overnight operations from $100 billion to $150 billion through Thursday.

The White House is also said to be considering further fiscal policy changes to offset further negative market action. This could include options to benefit small businesses, or more targeted programs for hard hit sectors, such as the travel industry.

HOW IS LFCM POSITIONING PORTFOLIOS?

LFCM continues to take this opportunity to re-position our portfolios and upgrade security quality across our SMA and asset allocation models. For example, in the U.S. Large Cap Growth Portfolio, the following names were sold and bought on March 6, 2020 (Look for additional Portfolio Update information on these changes soon):

BUYS

PYPL – Paypal operates as a technology platform company that enables digital and mobile payments on behalf of consumers and merchants. We decided to add 2% because the company is ideally positioned to perform well in various economic conditions.

CRM – Salesforce.com, Inc. designs and develops enterprise software. We decided to add 2% because the company has a strong balance sheet, growing free cash flow and a sound strategy to gain market share.

PHM – PulteGroup Inc. sells and constructs homes and purchases, develops and sells residential land and develop active adult communities. The company has multiple income streams that allows them to up-sell existing customers seamlessly. We added a 1% positon.

PTON – Peloton Interactive, Inc. provides recreational facilities. The company offers workout bikes for indoor cycling, as well as other fitness related products. We decided to add 1% of PTON to our portfolio because we factored that their business model will allow them to grow faster than their competitors. We project that the company has potential to capture a significant percentage of the health conscious community.

MCD – McDonald's Corporation franchises and operates fast-food restaurants in the global restaurant industry. We decided to add 1% of McDonald's to our portfolio because according to our estimates, the stock is currently trading at a discount to its intrinsic value. We project that the company has potential to provide both yield and capital appreciation.

SELLS

PE – Parsley Energy is an oil and gas company focused on the acquisition, development, and exploitation of unconventional oil and natural gas reserves. The company has struggled to increase revenue in a low crude oil environment just like its peers. Secular trends that we identified led us to reconsider the energy sector's weight within our portfolio.

PKG – Packaging Corporation of America manufactures container-board and corrugated packaging products for use in protecting goods during shipment. Although we like the company, the current valuation is above our price target. We will consider a possible re-entry point if our analysis shows significant upside potential.

LYB – LyondellBasel Industries manufactures plastic, chemical, and fuel products. The company's revenue declined significantly year-over-year and S&P downgraded the credit outlook to negative. We decided to liquidate the position and look for opportunities with higher upside potential.

LGIH – LGI Homes, Inc. designs and build homes in Texas, Arizona, Florida and Georgia. The company is struggling to generate positive free cash flow and is very sensitive to economic growth. Therefore, we decided to liquidate the position and look for opportunities with more upside potential.

CC – The Chemours Company manufactures and distributes performance chemicals. We do not believe that the company is positioned to gain market share in the current economic environment. Additionally, their credit outlook has been downgraded to negative by Moody's. Therefore, we decided to liquidate the position and look for opportunities with more upside potential.

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