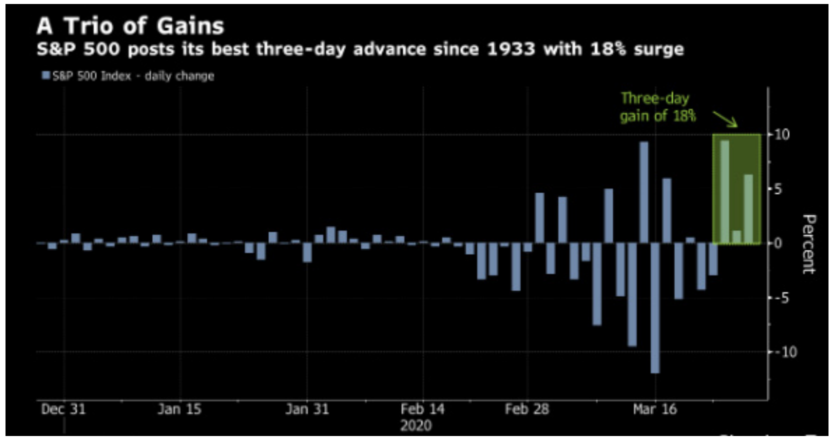
Level Four Capital Management

WEEKLY INSIGHT

MARKET COMMENTARY

LAST WEEK

U.S. Equities finished sharply higher as the S&P 500, Dow Jones, and Nasdaq all posted double digit gains on the week after experiencing the largest selloff since 2008 in the week prior. Over the course of the week, the S&P logged its first three-day rally since February, gaining 18% along the way, the largest three-day advance since 1933. The risk-on tone came as Congress passed the largest fiscal stimulus package in history aimed at helping cushion the blow from the spread of COVID-19. The ~$2T economic package and the Fed's announcement of unlimited Quantitive Easing helped soothe some investor concerns as jobless claims skyrocketed to new highs of ~3.3M+. The S&P was led to the upside by Utilities, Industrials, Real Estate and Energy as investors positioned themselves in a defensive manner, stepping back into equities. Industrials outperformed with the help of leadership from airlines who had been one of the worst performing groups during the stock rout (DAL +38.4%, AAL +35.3% and UAL +34.0%, as well as BA +70.5%), while Technology names outpaced broader market gains with the help of semi-conductor names.



Source: Bloomberg as of 03.31.2020

With uncertainty looming and more questions than answers, investors saw another flurry of corporate updates amid the COVID-19. Companies continued to close stores, halt production, withdraw guidance, suspend buybacks, and tap credit lines to help protect their balance sheets. The Financial Times noted that companies in Europe and North America had drawn at least $125B from their lenders in the past three weeks. As guidance has been suspended, we have seen 2020 earnings expectations decline, despite their being some positive comments from large corporations with operations related to China (NKE, MU). Even as earnings estimates continue to be revised downward, the major theme continues to be an earnings snapback in 2021. Additionally, given the current level of ambiguity surrounding the economic impact, we would not be surprised to see analyst's estimates becoming too bearish with companies reporting surprises to the upside.

Policy response was flagged as the most bullish theme on the week after Congress officially announced the passing of a fiscal stimulus bill that was later signed into effect by President Trump. While very few will read the 800+ page bill that was put fourth, below you will find a summary of the noteworthy actions in the package:

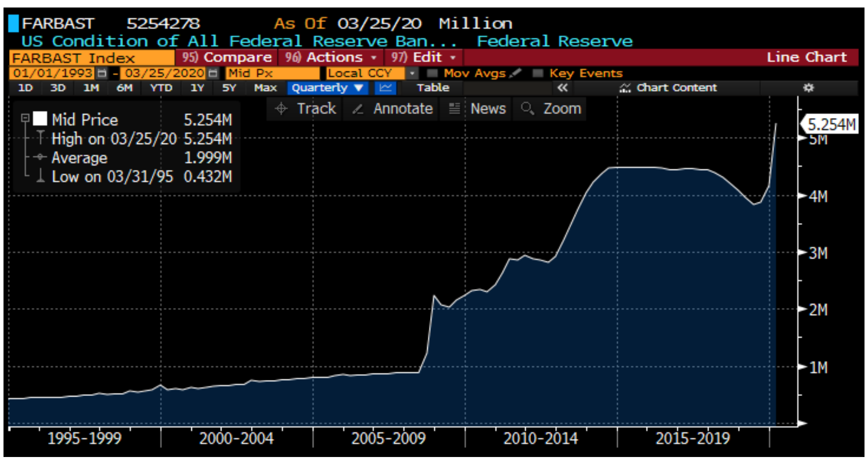
- ~$2T total package which is about 9.5% of total U.S. GDP
- Estimates have total economic output falling anywhere from $500M-$1T, which this stimulus deal will far outpace

- $250B in direct payments to Americans who will see a one-time check of up to $1,200 per adult & $500 per child based upon your income level in either your 2018 or 2019 tax filing (Phases down for income above $75K single filer/ $150K couple)
- $367B in small business loans that can be forgiven if employment retention metrics are adhered to
- $500B to large corporations via a bridge loan - it is worth noting that this does come with certain caveats including
    - Executive compensation restrictions
    - Ban of stock buybacks until a year after the loan is repaid
- Unemployment Insurance which will add $600/week to state unemployment benefits and has now been extended for those who have been forced out of work due to the pandemic
- $117B to hospital's and veterans' healthcare
- $50B to airlines- $25B for wages and benefits of employees while another $25B will go to loans for the airline
- Suspends student loan payments with no penalty through September 30th
- Delays payroll tax for employers until 2021 and 2022

Global Monetary And Fiscal Stimulus To Fight COVID-19 Impact
2020 Feb to Mar

	Central Bank Liquidity Injection		Govt Fiscal Stimulus		Central Bank Liquidity Injection and Govt Fiscal Stimulus	
	$ Bln	% GDP	$ Bln	% GDP	$ Bln	% GDP
U.S.	$1500	7.0%	$2756	12.9%	$4256	19.8%
Eurozone	$1100	8.3%	$480	3.6%	$1580	11.9%
Japan	$126	2.4%	$184	3.6%	$184	3.6%
U.K.	$387	14.1%	$38	1.4%	$425	15.5%
China	$1153	8.0%	$111	0.8%	$1264	8.9%
Others*	$406		$1416		$1948	
Total	**$4672**	**5.4%**	**$4984**	**5.8%**	**$9655**	**11.1%**

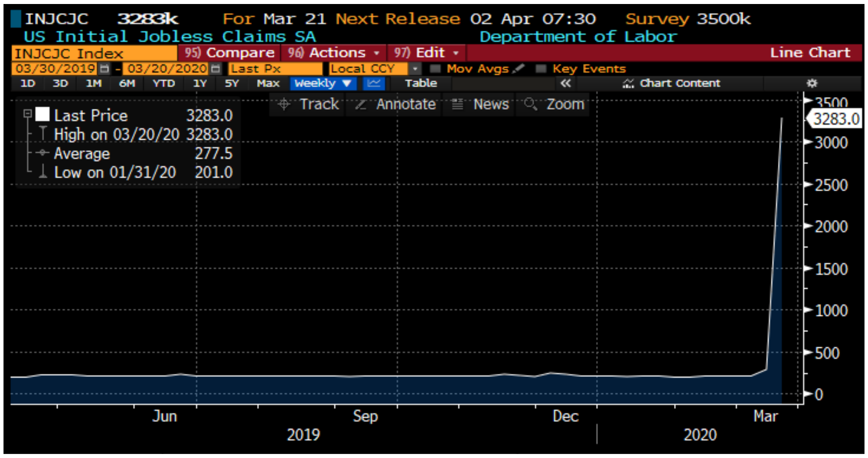
Source: Cornerstone Macro as of 03.31.2020



Source: Bloomberg as of 03.31.2020

And perhaps the most important aspect of the bill, according to David Bahnsen of Bahnsen Group, is the Exchange Stabilization Fund. This is where the Treasury Department will put $400B into the fund with the added ability to increase that multiplier 10-1, lending 10x the amount in the fund. This gives the Treasury Department the ability to activate nearly $4T in corporate lending. The Fed and the Treasury continue to work hand-in-hand coordinating policy actions. With the Fed's balance sheet expansion possibly heading to unprecedented levels, and the aggressive actions taken to address the crisis, their significance to capital markets has never have been greater than it is now. Even if the stimulus helps in the near term as many expect it to, these actions are more about Return on Invested Capital compared to the Cost of Capital. With this in mind it is our belief that, these policy tools help provide a promising backdrop for equities over the longer term.

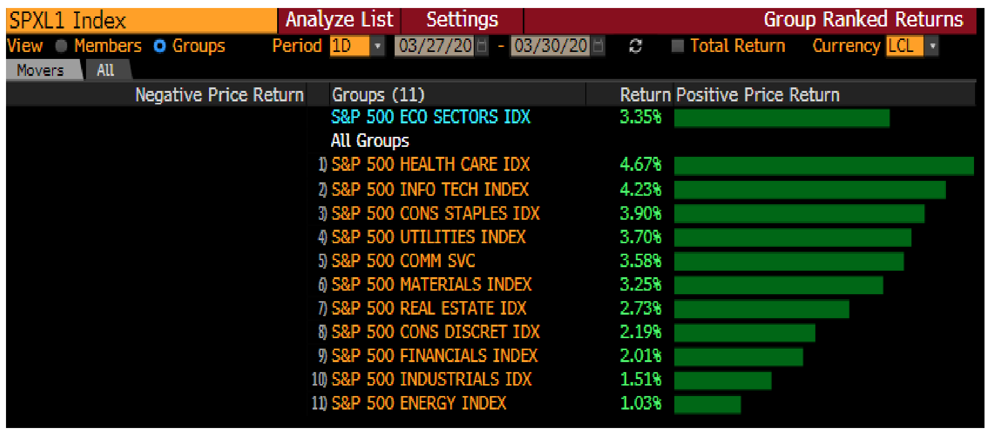
On the data front, unemployment numbers were as ugly as expected, but did provide some clarity and hard evidence to the problem. Analysts, strategists, and investors knew the headline number was going to be abysmal, and it was, but it helped the group project other forecasts moving forward. In the time leading up to the release, investors heard numbers ranging from 1M to 8M, making it very difficult to forecast future economic numbers and provide a base case for models which help drive valuations and ultimately stock prices of companies.



Source: Bloomberg as of 03.31.2020

THIS WEEK

U.S. stocks posted a strong Monday session led by gains in Health Care, Technology, Consumer Staples, Utilities and Communication Services, all of which outperformed broader indexes. The S&P closed 3.35% higher, Dow Jones ended up 3.19% and the tech-heavy Nasdaq outpaced broader indexes finishing up 3.62%. With markets starting the week higher, the S&P 500 posted its fourth advance in the last five sessions after markets saw deeply oversold conditions from the recent selloff. Energy stocks lagged again and were the worst performing sector on the day, as West Texas Intermediate crude prices touched 18-year lows, dipping below $20 per barrel before recovering as demand continues to remain weak due to the ongoing COVID-19 pandemic. The U.S. Dollar continued its march higher as the Bloomberg Dollar Spot Index jumped .7%, while treasury yields across the curve climbed slightly with improving sentiment.



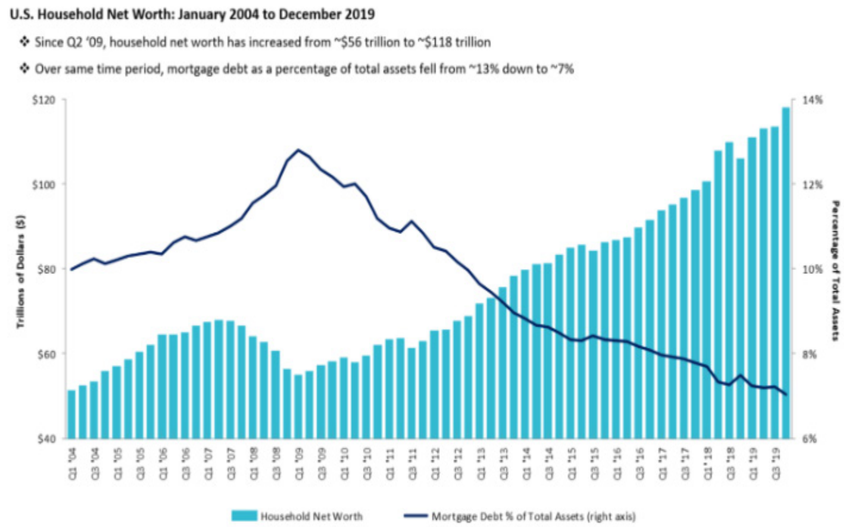
Source: Bloomberg as of 03.31.2020

U.S. COVID-19 cases topped 150K with nearly 3K deaths as of Monday afternoon with numerous states continuing to expand their current quarantines/lockdowns. On Sunday afternoon, the Trump administration announced that the CDC's social distancing guidelines would extend through April, despite previous comments made by President Trump in which he expressed hope to re-open the economy by Easter. While the headlines themselves read less than optimistic on the surface and signal more economic headwinds to come, there appeared to be more positive sentiment surrounding:

- Testing
- Potential treatments
- Better data out of Italy

While President Trump initially pushed to re-open the economy sooner than the end of April, Dr. Fauci, the nation's leading COVID-19 disease expert, warned that re-opening the country too soon could result in nearly 100K-200K deaths. That staggering statistic coupled with the recent report from Becker Friedman Institute showed that the mortality benefits of social distancing are about $8T, or $60K per U.S. Household. While 90% of the monetized benefits are expected to accrue in those 50 and older, overall, the analysis has shown that social distancing initiatives have in fact had, and will, continue to have a substantial economic benefit.

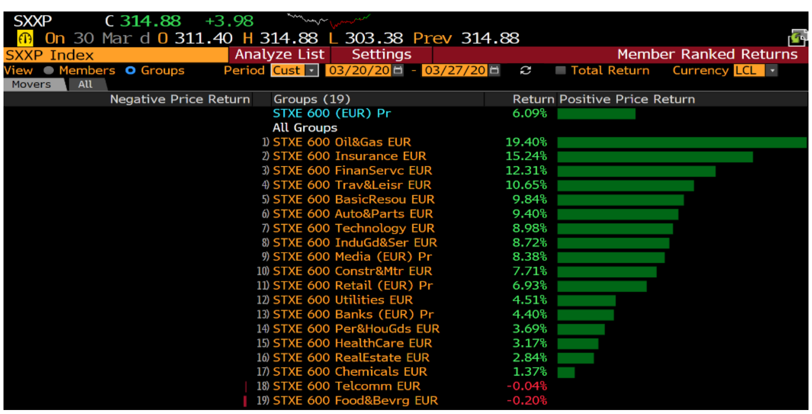
Additionally, as we mentioned in last week's commentary, there continues to be green shoots appearing day by day. While no one statistic can't portray the economic backdrop, an article from the Bahnsen Group showed that since the 2Q of 2009, household net worth has increased $62T, from $56T to $118T. Over the same time period, mortgage debt as a percentage of total assets has fallen from ~13% to ~7%. While we expect the volatility to continue for some time moving forward as the situation is ever evolving, it appears that "forced selling" has diminished with the continued system wide deleveraging. At current levels, various equity names look to be trading below their long-term fair value price that is discounting future free cash flow potential. Simply said, we believe there are well run companies that have been unfairly punished in the recent selloff. In the near term no one knows when the country will re-open or how dire the economic impact will be. However, we believe that the next few months will be very telling and provide a much better indication of what many are expecting to be a second half recovery.



Source: Bahnsen as of 03.31.2020

A lot has occurred in just a short amount of time and while we have heard this is relatable to "9/11" "The Financial Crisis" "The 1987 Crash" "The Dotcom bubble" or any number of previous tumultuous volatile times, it is important remember that we overcame each of those instances. There is still uncertainty that lies ahead, and each road to recovery will start somewhere. As we come out of this difficult and scary time we are reminded of perspective and what is most important remembering that this too shall pass.

THIS WEEK INTERNATIONAL



Source: Bloomberg as of 03.31.2020

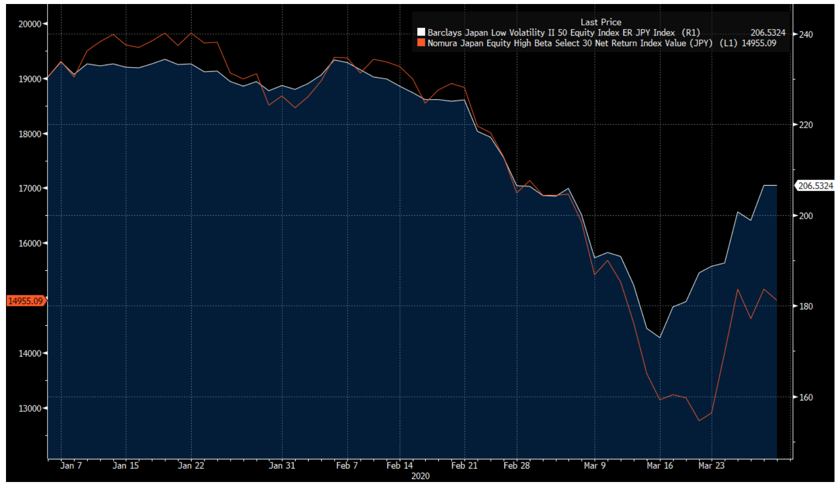
Europe - The Euro STOXX Index ended the week 6.06% higher led by oil & gas, financials, and travel and leisure. The deployment of monetary and fiscal stimulus across Europe improved investors' confidence in a quick economic rebound. Defensive sectors like telecommunication and food and beverage closed the week in the red, hinting strengthening market confidence.

The IHS Markit Flash Eurozone PMI Composite output fell to 31.4 in March, down from 51.6 in February. According to the survey's author, this is the lowest output since July 1998. Services PMI plunged to 28.4, down from 52.6 in February, while the Flash Eurozone Manufacturing PMI dropped to 44.8, down from 49.5 in February. The service sector was hit the hardest due to lockdown and travel restriction measures taken by governments to contain the pandemic spread. French business activity reached a 22-year low according to IHS Markit, with a Flash PMI Composite dropping from 52 in February to 30.2 in March. Germany's Flash PMI Composite followed the same pattern, sliding from 50.7 in February to 37.2 in March.

<u>APAC</u> - The SSE composite Index ended the week up 0.97%, lifted by real estate, up 3.01% and conglomerates, up 1.42%. The Chinese bond market remained attractive to risk-averse investors. Indeed, the 10-Year yield decreased by 2.5 basis points last week to close at 2.61%, 19 basis points below the 50-day moving average. The Chinese Yuan started the week at CNY7.12 and ended the week at CNY7.08. The Yuan rally started after the U.S. Dollar/Yuan pair reached a five-month high on March 19 at CNY7.15 exchange rate. With up to four-month lead on other countries regarding the peak of the pandemic, China's economy will likely be the first to show signs of recovery. Upcoming Caixin PMI report will provide further economic context regarding manufacturing activity in China.

In Japan, the Nikkei 225 jumped 17.14% last week, led by chemicals, materials, utilities and consumer staples. Investors are still cautious despite liquidity relief provided by the Bank of Japan. The spread between low-beta and high-beta stocks continues to widen in favor of low volatility, stressing a large-scale portfolio rotation out of risky assets.

To reduce imported cases, the government expanded its travel ban to people travelling from the United States, South Korea, China and most of Europe. After monthlong closures, schools are expected to reopen in April according to the Japanese education ministry.



Source: Bloomberg as of 03.31.2020

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