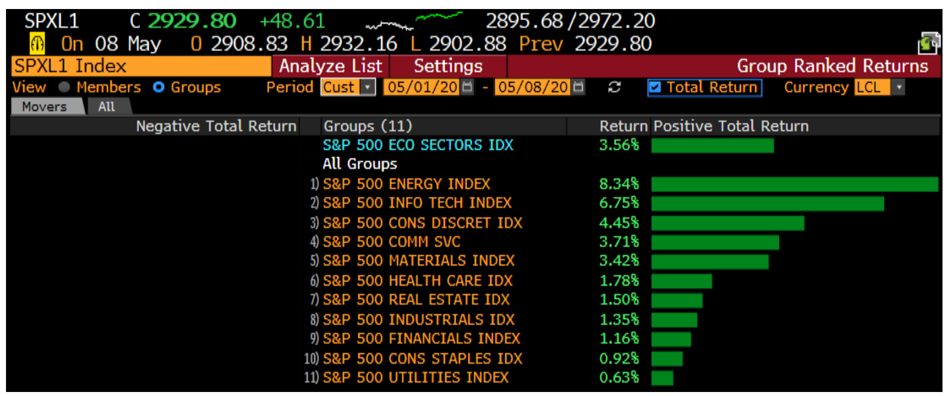
Level Four Capital Management

WEEKLY INSIGHT

MARKET COMMENTARY

LAST WEEK

U.S. equities staged an impressive rally last week with the S&P closing up 3.56% while the Dow Jones finished +2.67%. All 11 sectors closed in the green for the week ending with May 8th. Weekly gainers outpaced decliners by over 4:1 throughout the course of the week. The VIX declined 25% to 27.98, notching its lowest close since late February as near-term volatility plunged. Energy was once again the best performing sector with investors seeing another big bounce in crude, which finished up 25%. Technology was the second-best performing space in the market, extending its recent outperformance with help from semiconductor equipment, as well as some of the growthier-oriented software names. The Merrill Lynch FANG index also provided leadership closing up 4.76% on the week led by Google, which locked in a 5% gain over the five days, while the other constituents of the Merrill Lynch FANG index all ended up over 4%. Consumer Discretionary outperformed and was buoyed by home improvement retailers, homebuilders, and autos. Materials, Healthcare, Real Estate, Industrials, and Financials all lagged the broader market but still managed to post gains of over 1%. Healthcare lagged on moves in big pharma, which was the main drag on the sector, while biotech and med-tech generally saw outsized gains. Industrials trailed as airlines continued to falter and failed to find their footing. However, truckers, waste, and distributors fared well as various states continued to take additional steps towards reopening. Consumer Staples and other defensive pockets continued to underperform with the risk-on tone. The Dollar index was up 0.7% with better-than-feared economic data released while Gold posted a mere 0.8% gain.



Source: Bloomberg as of 05.13.2020

Treasuries were mixed across the curve with the longer-end seeing their yields rise, while the shorter-end saw a collapse in yields. The largest move came in the two-year note that saw yields fall by 17.47%, as it fell to a record low of 0.1388%, not far above zero. The previous record low, 0.1431%, had been reached in September 2011 amid concern over Europe's sovereign-debt turmoil and the U.S. economy's ability to recover from the recent recession. Thursday's decline, when the two-year hit a record low, was led by money-market rates, which began to price in a negative monetary policy rate for 2021. The price of January 2021 federal funds futures at one point topped 100, signaling investors to expect a decrease in the target interest rate range from its current levels of 0%-0.25%.

Despite the continuous barrage of headlines ranging from politics, Coronavirus updates, economic data, and corporate earnings, there were not many new developments behind the rally. Contrasting arguments continue to be made by both bulls and bears regarding the direction of the next move—either a leg higher or a leg lower.

According to Cornerstone Macro, the following points are being used to support each case:

THE BULL CASE:

1. Phase four stimulus package in the works
2. Reopening of economy
3. China stimulus
4. Extremely accommodative monetary policy
5. As of now, companies saying large percentage of employees will be hired back
6. Bearish sentiment
7. 400+ Pharma companies working on therapeutics

THE BEAR CASE:

1. Second wave/never re-open
2. 15% unemployment rate (or any other recent eco data point)
3. Recovery will be slow and will come in spurts
4. Bankruptcy wave
5. Dem sweep
6. Valuation

Source: Cornerstone Macro as of 05.13.2020

Regardless of where you stand and which side you believe, the primary perception of the recent strength has been the unprecedented amount of fiscal and monetary policy support, coupled with the partial reopening of global economies. Additionally, signals show global economic activity may have bottomed, however, corporate commentary surrounding the stabilization and improvement in business activity has also helped sentiment advance recently. Thus far, according to Cornerstone Macro, there has been around $6.2T of central bank stimulus to go along with $3.3T of fiscal stimulus resulting in roughly $9.5T of liquidity injections or 44% of U.S. GDP. This, paired with other global central bank actions, has resulted in nearly $20T in added global liquidity equating to almost 24% of world GDP. Where this money will ultimately fall is yet to be seen, but many believe it will be in various asset classes, helping to support the overall market.

Global Monetary And Fiscal Stimulus To Fight COVID-19 Impact 2020 Feb to Apr (CSM)

	Central Bank Liquidity Injection		Govt Fiscal Stimulus		Central Bank Liquidity Injection and Govt Fiscal Stimulus	
	$ Tln	% GDP	$ Tln	% GDP	$ Tln	% GDP
U.S.***	$6.21	29.0%	$3.30	15.4%	$9.51	44.4%
Eurozone	$1.10	8.3%	$2.83	21.2%	$3.93	29.5%
Japan**	$0.75	14.6%	$0.99	19.2%	$1.74	33.7%
U.K.	$0.25	9.0%	$0.14	5.1%	$0.39	14.1%
China	$1.44	10.0%	$0.68	4.7%	$2.11	14.7%
Others*	$0.68		$2.09		$2.76	
Global	$10.42	12.0%	$10.02	11.6%	$20.44	23.6%

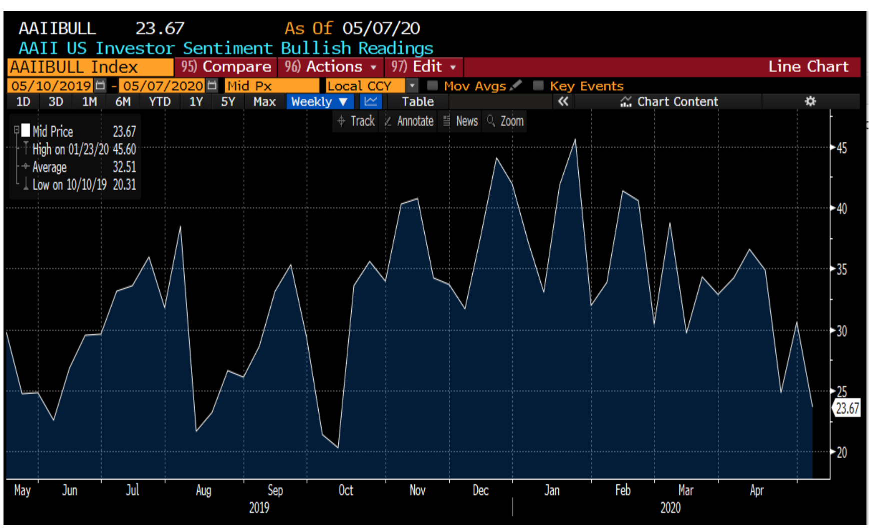
*incl RoW and ADB, IMF, WB

*** Fed's $6.2 tln injection incl the $2.5 tln announced on Apr 9, and the $3.7 facility.

** "BOJ Vows to Buy as Many Bonds as Needed in Stimulus Move." (BBG, 4/27)

Record Amount Of U.S. Monetary & Fiscal Stimulus.

Source: Cornerstone Macro as of 05.13.2020



Source: Bloomberg as of 05.13.2020

Despite the move higher, a slew of headlines continues to surround massive job losses, bankruptcies, the quality of the recent rally given large tech's outsized contribution, and the possibility of a second wave potentially hindering any recovery. However, one of the big themes of the week surrounded the disconnect between market and fundamentals, which has resulted in a FOMO trade higher. The American Association of Individual Investors (AAII), which measures individual investor sentiment over the next six months, fell to its lowest level since October. Bullish sentiment fell to 23.7% while bearish sentiment jumped to 52.7%, which was the highest level since April 2013. This coupled with Bank of America's most recent Flow Show report revealed investors pulled $16.2B out of global equities. This was the largest redemption since March and continues to highlight the discrepancy between market fundamentals and recent price action. With the recent outflows in global equities, money market funds continue to be the big winner attracting another $53.5B, bringing assets in the space up to $4.8T. Going into the week, JPMorgan believed that short covering, which has been one of the main tailwinds behind the move higher, was only ~50% of the way done, adding that global investors remain underweight stocks versus bonds.

On the data front, Non-Farm payrolls fell by a record high of 20.5M in April, while the unemployment rate spiked to 14.7%–a post-world war record. Despite these high unemployment numbers not seen since the Great Depression, the headline numbers were better

Source: Bloomberg as of 05.13.2020

than expected. There continues to be a "more positive" spin surrounding earnings as those who miss expectations continue to be "punished less" by around 2%, according to FactSet earnings insight. Investors continue to be focusing more on qualitative metrics rather than quantitative and appear to be looking to corporate commentary for signs of stabilization.

U.S.-China tensions eased throughout the week helping curtail yet another headwind. In recent weeks, President Trump has ramped up criticism of China and threatened to retaliate with additional tariffs or even abandoning the phase one trade deal all together. It is reported that U.S. Trade Representative Robert Lighthizer, Treasury Secretary Steven Mnuchin, and Chinese Vice Premier Liu He conversed by phone on Friday saying they have all pledged to create favorable conditions for implementation of the bilateral trade deal. Both the U.S. and Chinese side agreed that good progress is being made, and they fully expect to meet their obligations in a timely manner. Despite President Trump contradicting his top-trade representatives on Friday by saying he could abandon the trade deal; many believe this is not feasible given the fragile state of not only the U.S., but also the global economy.

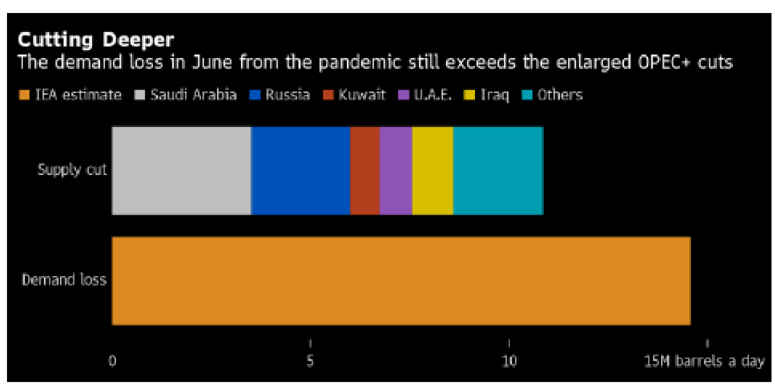
A few other interesting datapoints provided by one of our trade partners include:

- Flows were net sales Monday through Wednesday, however saw a sharp reversal on Thursday and Friday
- Technology, Consumers and Industrials were net buys, while Healthcare was a net sell
- Activity in Long-Only managers picked up
- Volumes were the lightest investors have seen since mid-February. Off-exchange volume remained elevated by about 40%, while remaining off peak levels reached in April

THIS WEEK

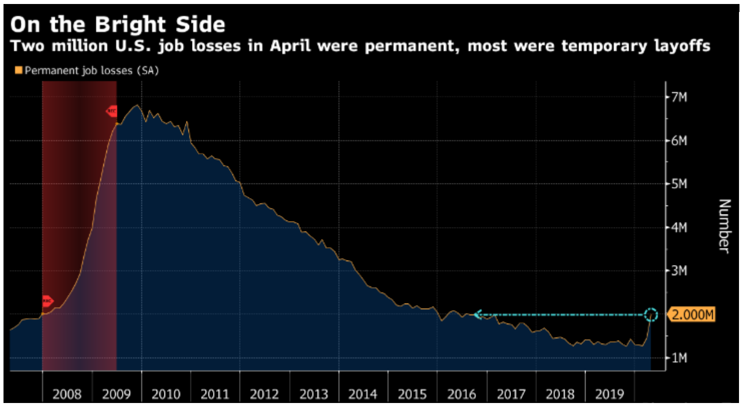
U.S. stocks closed mixed to start the week as the S&P 500 finished essentially flat on the day (+0.01%), while the Dow closed down 0.45%, being dragged lower by financials. The Nasdaq Composite jumped just over 75bps amid strong gains in biotech and software names, with the IBB (Nasdaq Biotech ETF) trading to new 52-week highs. The gains in the index makes it the sixth straight day of ending higher and the tech heavy index is now just under 6% from all-time highs set in February.

WTI crude turned lower midday Monday closing down 2.4% off after both U.S. and Brent posted their largest weekly percentage gains on record last week amid hopes another deal to cut additional crude supply will emerge. Saudi Arabia pledged to cut another 1mbpd of crude in June. This is in addition to the already agreed upon production cuts that began on May 1st, taking output to its lowest levels in 18 years. In conjunction with Saudi's announcement, the UAE and Kuwait have also announced additional output cuts in order to support the recently beaten down commodity. OPEC+ is expected to now reduce supply by almost 11 million barrels a day from the market in June; however, that still remains short of the daily demand reduction of almost 15 million barrels estimated by the International Energy Agency.



Source: Bloomberg as of 05.13.2020

Focus this week will surround Federal Reserve Chairman Jerome Powell's outlook on the economy at a webcast event on Wednesday after futures markets started to price in negative interest rates last Thursday. Additionally, House Democrats have said their newest relief package vote will come no sooner than Friday despite not having Senate Republicans or President Trump's support on key parts within the bill. Investors will also continue to focus on corporate earnings with roughly another ~65 S&P 500 companies expected to report over the course of the week.

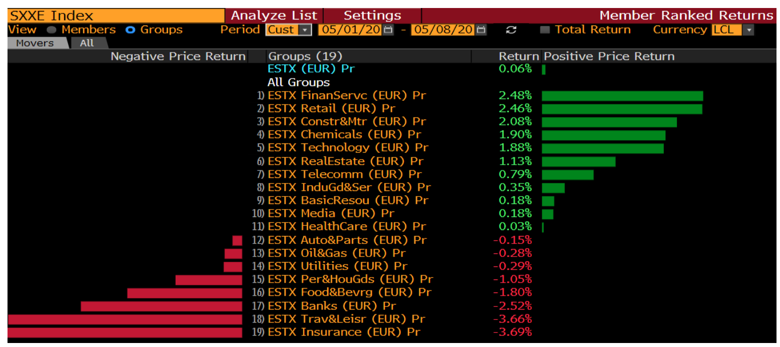


Source: Bloomberg as of 05.13.2020

New data from Friday's abysmal jobs report showed that two million of the 20+ million people to lose their jobs believed their dismissal was permanent, according to Labor Department data. Roughly about 18+ million American were temporarily laid off and have the potential to return to work more quickly than initially thought, as various states push to open back up sooner than some companies anticipated. The concern for investors still remains as sluggish demand and a slower recovery could cause businesses to delay bringing workers back.

THIS WEEK INTERNATIONAL

Europe - The Euro STOXX Index was up 0.06% last week, led by financials, retail and construction.



Source: Bloomberg as of 05.13.2020

Official numbers in Germany showed that the infection rate rose a few days after the government eased COVID-19 restrictions. Angela Merkel, Chancellor of Germany, asked local authorities to reimpose restrictions if cases rise above 50 per 100,000 people. In the UK, Prime Minister Boris Johnson published a 50-page plan to reopen the economy. According to the report, the UK will gradually reopen to collect data and adjust accordingly. A new COVID-19 Alert system with five levels will determine how quickly restrictions can be lifted. He also gave a timeline for reopening schools and businesses. Contingent on the infection rate, schools could reopen as soon as June 1st and some hospitality businesses and public places as soon as July 1st. The FTSE was up 2.54% last week with strong performance from Tech Hardware up 11.34% and Health Care Equipment, up 7.71%.

In France, the government has decided to ease lockdown restrictions as well. People will still need travel certificates when they leave their home. France is also testing a contact tracking and tracing app that may be launched as soon as June 2nd. According to the National Institute of Statistics and Economic Studies, French Consumer Confidence Index fell to 95 in April, versus 103 in March.

APAC - The Shanghai Composite was up 1.23% last week, led by Industrials, Communications, and Utilities.

According to the latest data compiled by Rhodium Group, Foreign direct investment from China to the U.S. dropped to $5 billion in 2019, which is the lowest level since 2009. It is believed that this decline stems from China's tightening outbound capital regulation combined with the U.S./China trade war. Investments in technology also dropped as a results of U.S. restrictions imposed on Chinese investments last year. China's investments in the U.S. peaked in 2016 with $46 billion deployed.

In Japan, the Nikkei 225 was up 2.85% last week, led by Industrials. Some businesses and schools reopened although Tokyo remains in a state of emergency. The government announced most prefectures will reopen on Thursday. The Japanese Yen closed at ¥106.65 last Friday, down from ¥106.91 a week ago.

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