Level Four Capital Management

WEEKLY INSIGHT

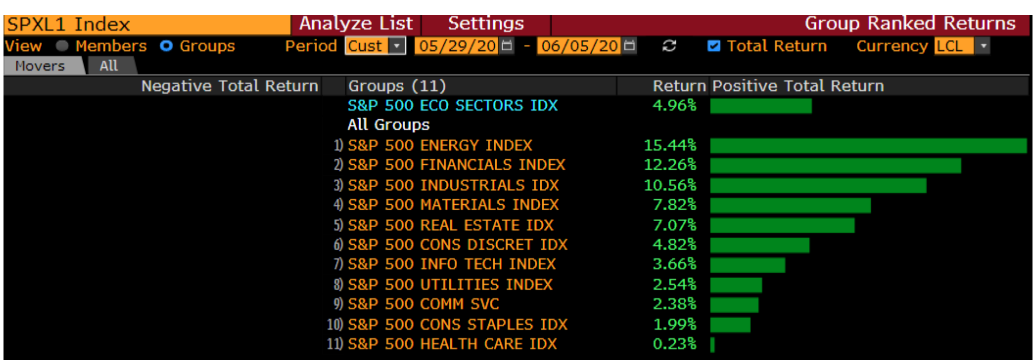
MARKET COMMENTARY

LAST WEEK

U.S. equities once again closed higher for a third straight week as value and cyclical related names continued to outpace growth and momentum factors. The Dow rose 6.8% on the week, trailed by the S&P & Nasdaq which finished up by 4.96% and 3.43% respectively. For the second straight week, all 11 sectors again finished higher over the five days. This would have been three straight weeks; however, Healthcare was the lone loser the week of May 15th closing down .71%. Energy was the best performing sector, rising 15.44% as WTI crude gained 11.5% on the week. Financials were the next best performing sector, rallying 12.26% amid strength in bank related names once again. Industrials climbed 10.56%, led higher by airlines, aerospace, and machinery related names, while the Materials sector outperformed broader markets with strength in industrial metals, chemicals, and packaging which more than offset weakness in precious metals. Gold closed the week lower by nearly 4.00% as investors' risk appetites increased. Technology trailed the tape as software and FANG+ related names lagged broader markets again as we continue to see investors taking a breather from growth related names. Some defensive sectors such as Consumer Staples, Utilities and Healthcare underperformed with a rotation out of stay-at-home names as states continued to take further steps of re-opening. With the risk-on tone gripping financial markets, yields climbed and Treasury prices fell, with the 10s/2s spread steepening to .689bps. The Dollar index was down 1.4% despite economic data coming in largely better than feared.

Expectations of a V-shaped recovery are the main driver of the weeks' move higher as high-frequency data continues to show improvements in:

- Air travel traffic
- Truck traffic
- Requests for driving directions
- Restaurant reservations
- Consumer discretionary purchases such as accessories/clothing



Source: Bloomberg as of 06.09.2020

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Additionally, helping to improve the narrative was better economic data which included:

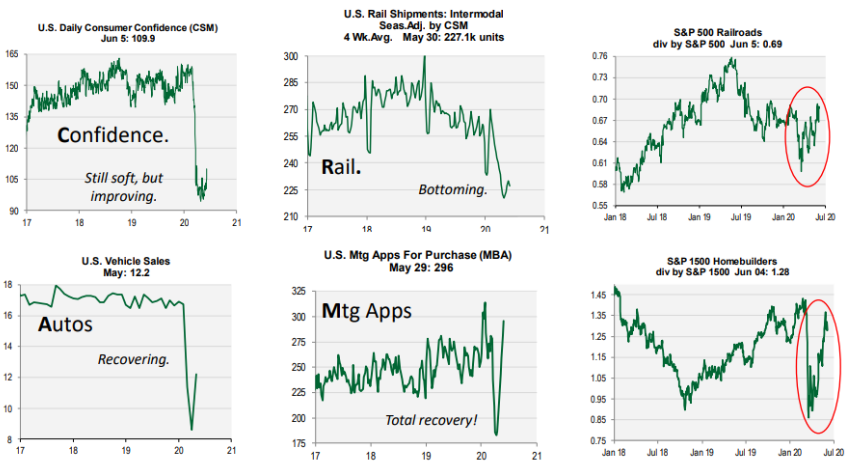
• U.S. auto sales which soared 40% m/m in May (Wall Street Journal reported that some dealerships are running low on some of their most popular models

• Nonfarm payrolls showed hiring has begun to pick back up as the headline number increased by 2.5M in May versus expectations which called for a decline of 7.5M (see below for more details)

• The unemployment rate, which fell to 13.3% from 14.7%, was much lower than the consensus of 19.0% economist were anticipating

• Initial jobless claims, which despite coming in higher than expected, continued their move lower dropping below 2M

• Non-Manufacturing PMI's, which although remained in contraction territory showed a beat over estimates

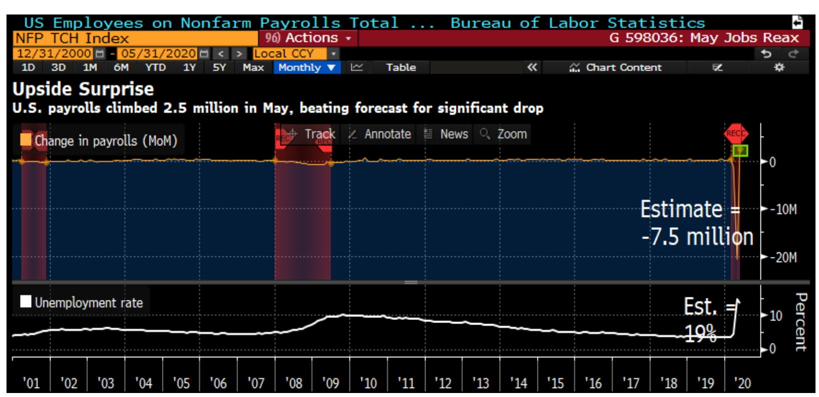


Source: Cornerstone Macro as of 06.09.2020

While the U.S. jobs reports can indeed surprise investors relative to expectations, there has never been as large of a discrepancy between actual data and estimates. Before the most recent report, the largest single monthly miss on payroll numbers was 318,000 in February 2003, according to Bloomberg survey data dating back to 1996. Of the 78 economists surveyed by Bloomberg, the most recent consensus called for the unemployment rate to approach 20%, the highest since the Great Depression, with the most optimistic forecast calling for an 800,000 decline in jobs. While high frequency data has been pointing to an economic bottom since mid-April, jobless claims did not fit that same mold, suggesting there was no follow-through to the labor market. Economic models failed to take into account the government's response which included massive monetary and fiscal stimulus, specifically the Paycheck Protection Program (PPP).

Markets have remained resilient and continue to ignore potential headwinds, pushing to their highest levels since March. Investors appear to brush aside concerns including:

- Civil unrest throughout the country
- Concerns that stocks may appear to be pricing in an unrealistic economic/earnings recovery
- Potential political headwinds later this year ahead of the election



Source: Bloomberg as of 06.09.2020

The contrarian narrative believes there may still be room to run. Despite the impressive rally off the March 23rd lows, JPMorgan noted that at the beginning of the week investors remain underweight equities, pointing to the current equity allocation of 40% for non-bank investors. This number remains well below highs of 49% seen in 2018. Also, adding to additional market/sentiment support was a Wall Street Journal article pointing to Fed actions. While promising to take whatever steps were necessary, the Fed has not actually purchased a single corporate bond, signaling there are many more measures that could be taken by the Central Bank if needed. Over the last 10 weeks, corporate bond issuance topped $1T, a number that was not reached until November in 2019. In fact, last week the Fed announced they will continue to further slow the pace at which they buy Treasuries under the open-ended and unlimited program that was announced in March by reducing the daily amount to around $4B/day, which remains drastically below the peak of $75B/day in mid-late March.

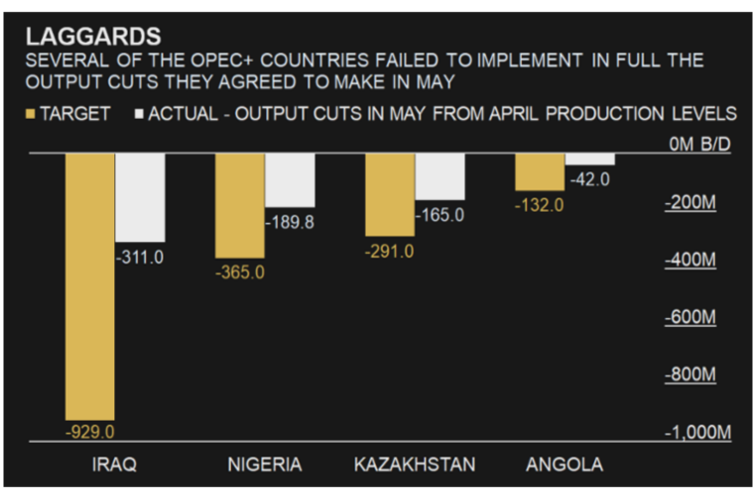
Corporate commentary continues to lean positive as market participants focus on demand improvement rather than softness in economic data, as seen in previous years. Simply put, investors appear to be viewing the *glass half full* rather than the *glass half empty*. Positive corporate commentary throughout the week included:

- **American Airlines (AAL)** +77.1% said they plan to fly 55% of their domestic schedule in July versus 20% in May
- **Visa (V)** +2.2% announced U.S. payment volume declined only 5% in May, which was much better than the 18% decline seen in the month prior
- **LYFT** +23.5% reporting rides increased 26%in May from April
- **Alcoa (AA)** CFO comments saying China is leading the way of a V-shaped recovery

THIS WEEK

The S&P gained 1.70%, rallying 461 points on Monday, rising to 15-week highs while the Nasdaq composite set all-time highs for a second straight session. The Small Cap Russell 2K index outperformed its Large Cap peers, finishing 1.97% higher amid the easing of lockdowns. Major averages are up more than 45% off their March 23rd lows, with the S&P now turning positive for the year as last week's move higher continued into the start of the week. The S&P 500 and the Dow are now about 5.5% and 7.5% away from their respective all-time closing highs.

Source: Bloomberg as of 06.09.2020



Source: Bloomberg as of 06.09.2020

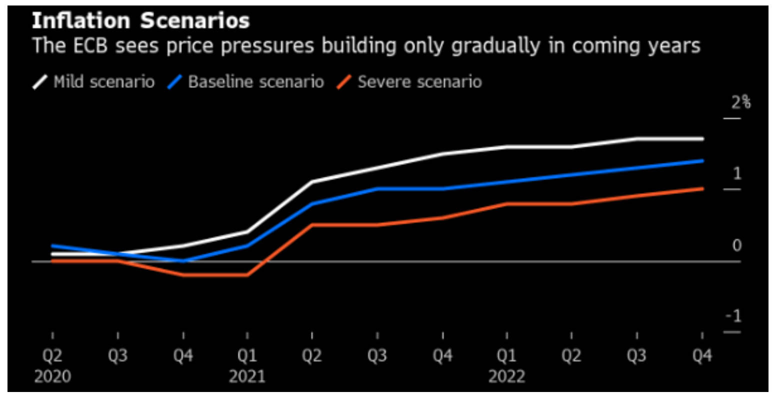
The Energy sector led the move to the upside on Monday closing higher by 4.32% as OPEC+ agreed to extend record output cuts over the weekend. OPEC+ announced they would look to crack down on countries within the group that do not comply with production cuts and even force them to make up for commitments they have failed to keep. A move that was largely aimed towards Iraq appeared to pay dividends as Iraq, OPEC's second largest producer said they will be fully committed to the output agreement and will back all efforts to re-balance markets. Previously, the country had failed to live up to expectations with production cuts. The previous extra production cuts were primarily absorbed by Saudi Arabia, which curtailed production by more than originally agreed upon in an all-out effort to support global oil markets.

Market commentary continues to show the varying opinions on the market's next move; continuing higher or taking a breather and turn lower. On Monday alone, Citigroup's strategist Tobias Levkovich said that positioning in U.S. equities may now be overly extended, while famed investor Stan Druckenmiller, who last month warned about "owning stocks", said he now believes he was "far too cautious" during the current market rally, stating "I was up 2% the day of the bottom, and I've made all of 3% in the 40% rally". Hedge funds like Druckenmiller continue to prepare for another market downturn in stocks by reducing equity exposure, raising cash levels and buying speculative puts. However, just as we have seen before, the group as a whole has often times been mispositioned, leading to underperformance.

THIS WEEK INTERNATIONAL

Europe - The Euro STOXX Index surged 9.34% last week, led by banks, up 20.18% and Insurance, up 17.56%.

The European Central Bank (ECB) expanded the emergency bond-buying program by $687B last week. According to Christine Lagarde, "these measures have not only prevented the economy from entering depressed and deflationary conditions but have also contributed to supporting employment and reducing financial stability risks". The ECB sees inflation remaining below their 2% target in the coming years.



Source: Bloomberg as of 06.09.2020

In Germany, the Bundesbank claimed that the worst of the crisis may already be past. The Economy Ministry echoed this by stating "with the step-by-step easing of protective measures and the pickup in production in the car industry, the economic recovery is now taking hold". The German 10-year government bond closed at -0.27% last week, versus -0.44% a week earlier. The Dax Index was up 10.88% last week.

In the UK, investors are no longer betting that Bank of England (BOE) will take interest rates to negative territory. However, the market expects the Central Bank to increase its government bond purchase activity this month. The latest balance sheet release shows that BOE increased its asset purchase facility by 2.4% in the past week. The FTSE All-Share Index climbed 6.72% last week, led by oil equipment service, up 29.58% and life insurance, up 20.58%.
In Switzerland, the government announced that they will lift restrictions on travel from European Union countries and Britain starting June 15th. In addition to this, the Swiss Market Index was up 3.65% last week.

APAC - Starting Saturday in China, travel restrictions from Wuhan and surrounding provinces will be lifted in Beijing, as will the 14-day mandatory quarantine. Additionally, wearing a mask and temperature check will no longer be required. The Shanghai Composite Index was up 2.75% last week, led by communications, up 3.11% and real estate, up 3.07%.

In Malaysia, the government announced a $8.2B stimulus package to spark the recovery. The manufacturing, real estate, palm oil, auto, airline and tourism sectors will receive tax breaks. The Prime Minister added that zero a tax rate "for up to 15 years" will be granted to "foreigners investing more than $117M in manufacturing and fixed property sector". Malaysian stocks were up 4.64% last week.

In Japan, Bank of Japan published its bank lending statistical summary for the month of May showing that bank lending grew 5.1% year-over-year in May while deposits rose 6.2%. The Nikkei 225 was up 4.21% last week, led by auto manufacturers.

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