Level Four Capital Management

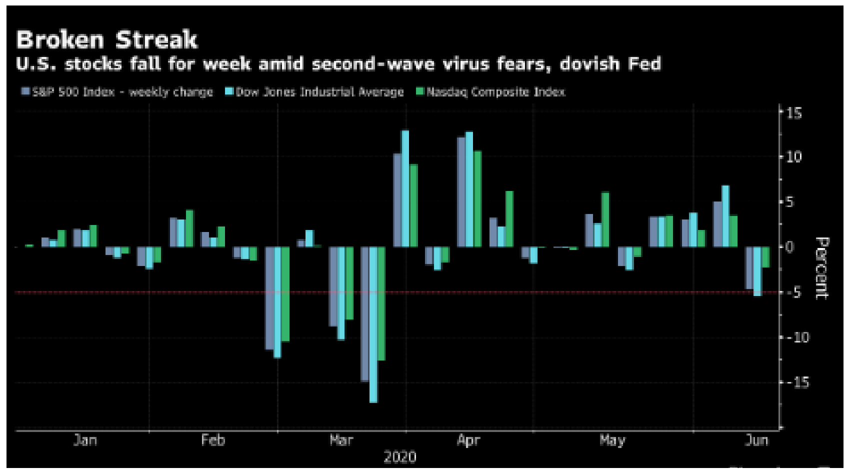
WEEKLY INSIGHT

MARKET COMMENTARY

LAST WEEK

U.S. equities finished lower on the week and snapped their impressive three-week winning streak where the S&P gained 11.68% for the period May 15th through June 5th. For the week, the S&P declined 4.73% with numerous reasons emerging for the pullback, including:

- Increased worries regarding an uptick in Coronavirus infections and hospitalizations
- A continued disconnect between the magnitude of the bounce and a weaker macro backdrop
- President Trump's slippage in the polls
- Fatigue by retail investors



Source: Bloomberg as of 06.17.2020

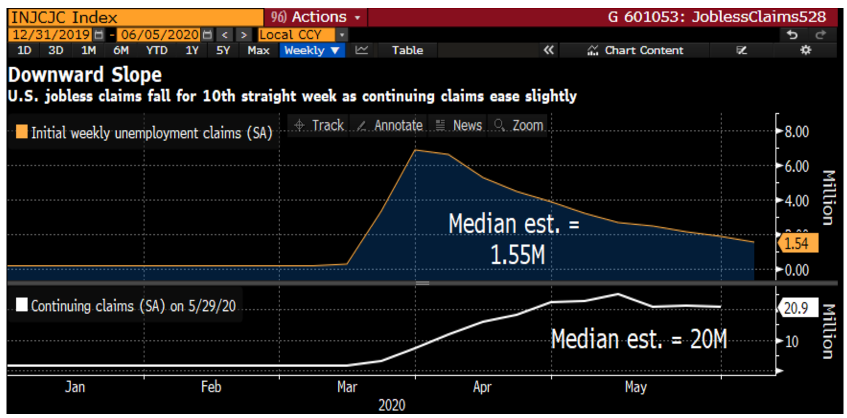
Stocks saw volatility storm back on Thursday as the S&P closed down 5.9%, its largest down day in 12 weeks, only to rebound by 1.3% on Friday, its fourth consecutive Friday of ending higher. Over the course of the week, markets were led to the downside by Energy, Financials, Industrials, Materials, and Healthcare, all which unperformed. Energy was the worst performing sector as U.S. Crude recorded its first weekly loss in almost two months (seven weeks), dropping 8.0% on the week amid ongoing fears that a second wave of infections could derail the fragile recovery. Banks were another area of weakness and were among some of the worst performers on the week with the Nasdaq Bank Index (BKX) losing 10.8% after rallying 57% since their lows over two months ago. Airlines and Consumer Discretionary fared worse, in particular retail/apparel related names gave back some of their recent gains with JETS (Airline ETF) trading down 9% and XRT (Retail ETF) off about 6.9% on the week. MKM partners noted that the average active manager reduced their overall position of equities to 77% from a recent high of 92%.

Source: Bloomberg as of 06.17.2020

Traction gained by the value/reopening trade reversed and came under pressure over the course of the week following its recent outperformance while growth and momentum names were more resilient. Large Tech outperformed on the back of Amazon +2.5%, Apple +2.2%, Microsfot+0.3%, Facebook -1.0% and Google -1.8% which held up better than broader markets and provided some cushion as the five largest stocks in the S&P 500 account for 20% of the index. Risk-off assets caught a bid as Treasuries were stronger across the curve, with the one-year yield contracting ~20 bps for the week to settle at .7034%, while gold gained 3.0%.

Investors appeared to be looking for an excuse to seemingly take profits off the table after the ~40% move higher from the March 23rd lows. Over the course of the week we saw an uptick in Coronavirus related headlines, many of which leaned more negative than positive. Headlines seen throughout the week appeared to be overblown versus the actual “second wave” numbers/datapoints that were released. Although markets moved lower, many seemed to downplay the concerns of potential re-imposed stay-at-home orders and continue to believe any uptick should not derail the reopening push. The debate on whether or not the U.S. has pushed to reopen too quickly came back into focus with some states further easing social distancing measures as they move forward with the continued easing of restrictions. Reuters noted that Arizona, Utah and New Mexico all saw 40%+ increases for the week of June 7th, while new cases in Florida, Arkansas, South Carolina and North Carolina rose by more than 30%. Despite the increase in case count, part of the rise in new infections has been attributed to the increase in testing, which is up over 200% since early May. The Trump administration has repeatedly said they will not shut down the U.S. economy over new infections and that President Trump is “absolutely disinclined” to doing so. Additionally, as we near July 31st, government officials will be less likely to close down again, as the extra $600 weekly payments are set to expire. Without additional stimulus for citizens, any further re-imposed closing measures would look to be to be even more detrimental to the U.S. economy and the recovery.

On the additional stimulus front, there appears to be more noise than substance as Senate/House Republicans have provided pushback on another relief package after the better-than-expected May employment data. Additionally, data releases continue to surprise to the upside putting further pressure on another stimulus package as initial jobless claims fell for a tenth consecutive week to 1.54 for the week ending June 6th. Continuing claims also fell to 20.9, but decreased less than anticipated. Treasury Secretary Mnuchin said that the Trump administration is strongly considering another round of one-time stimulus checks however, there remain doubts as to what Senate Republicans will approve, if anything. Formal negotiations on another bill are not expected to start for at least another month.



Source: Bloomberg as of 06.17.2020

Candidate	Value	Daily Volume	1D Net Chng	5D Net Chng	1M Net Chng	3M Net Chng	6M Net Chng	Update Time
2020 Presidential Winning Party -- Source: Predictit (4)								
Democratic	62.0 y	10264	+1.0	+3.0	+9.0	+8.0	+9.0	06/14
Republican	42.0 y	15864	--	--	-7.0	-6.0	-7.0	06/14
Libertarian	1.0 y	2641	--	--	-1.0	--	-1.0	06/14
Green	1.0 y	2614	--	--	--	--	-1.0	06/14
2020 Senate Control -- Source: Predictit (2)								
Democratic	58.0 y	1598	--	+2.0	+7.0	+13.0	+24.0	06/14
Republican	42.0 y	2129	--	-4.0	-9.0	-16.0	-26.0	06/14
2020 House Control -- Source: Predictit (2)								
Democratic	83.0 y	301	+1.0	+2.0	+5.0	+8.0	+12.0	06/14
Republican	18.0 y	2784	-1.0	-2.0	-4.0	-11.0	-13.0	06/14
Donald Trump Job Approval -- Source: RealClearPolitics (2)								
Disapproval	55.3 y		+.2	+.3	+3.9	+2.8	+2.3	08:40
Approval	42.4 y		--	+.3	-3.7	-2.4	-1.6	08:40
Donald Trump Favorability Polls -- Source: RealClearPolitics (2)								
Unfavorable	54.7 y		+.2	--	+2.3	--	+.8	06/10
Favorable	41.1 y		-.2	-.3	-.9	-1.7	-1.7	06/10

Source: Bloomberg as of 06.17.2020

Also weighing on markets, although it did not receive as much attention versus the former topic, were President Trump’s most recent poll numbers. According to The Hill, the President’s job approval declined by 10% to a mere 39% in the latest Gallup survey, which was a sharp decline from the personal high of 49% in May. The approval rating was down 7% amongst both Republicans and Independents which now stand at 85% and 39% approvals respectively. According to ABC News, some Trump advisers have become increasingly worried about internal polling numbers showing a lackluster performance in swing states. The main difference in relation to markets between the Trump and Biden administrations surround corporate taxes. Earlier in the week, Goldman noted that Biden’s plan would raise the federal tax rate on domestic income to 28% from its current level of 21%, ultimately reducing their 2021 S&P 500 earnings estimates to $150 from $170.

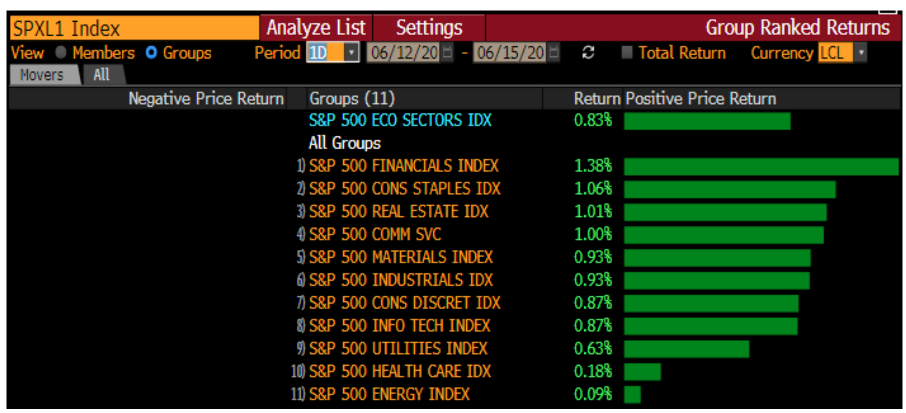
While the Fed's decision to not move rates was expected, there were some dovish takeaways from the FOMC meeting including:

- More cautious recovery outlook commentary from Fed Chair Powell
- The Fed stating they would continue purchasing Treasuries and MBS "at least at the current pace" to ensure smooth market functioning ($80B/month for Treasuries, $40B for MBS)
- The expectation to keep rates near zero through at least 2022 at which they anticipate GDP of 3.5%, Inflation of 1.7% and an unemployment rate of 5.5%

In a survey conducted by Barclay's of 179 hedge fund investors throughout March and April representing $480B globally, showed that assets may continue to consolidate even further in the hedge fund space. As the stock market continues its fragile recovery, investors may pull as much as $100 billion from the hedge fund industry this year, having already pulled $30B as a result of the economic fallout from the Coronavirus crisis. Outflows of that amount would mark the largest drawdown since the global financial crisis when the industry saw redemptions of $154B in 2008. While many of the redemptions have been due to liquidity driven measures (funding other illiquid investments), according to Kate Holleran, the Managing Director of Capital Solutions at Barclays, some could be performance related as managers continue to fail at outperforming their benchmarks and provide justification for the higher fees charged. Hedge funds have kept pace with the S&P 500 Total Return Index for the year, down about 5% through May, according to Hedge Fund Research. With their recent performance tracking broader markets as a whole, only 21% of investors indicated they were planning on increasing their hedge fund investments compared with 41% in December, while those seeking to redeem increased to 18% from 16% over the same time frame.

THIS WEEK

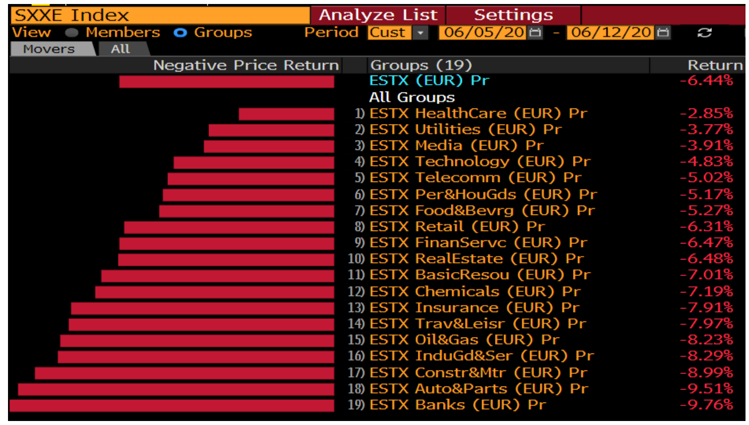
U.S. markets all finished in the green on Monday, staging an impressive rally off the lows of the day. The Nasdaq led the way higher, closing up 1.43%, followed by the S&P & Dow which closed up .83% and .62% respectively. Monday's strong session added to the streak of seven consecutive positive starts to the week led by Financials, Consumer Staples, Real Estate, Communication Services, Materials, Industrials, Consumer Discretionary, and Technology, all which outperformed the broader market. Equities initially started the session lower, with the Dow falling as much as 762 points. However, it moved higher in the afternoon session staging a near 4% rally after the Federal Reserve said they would begin buying individual corporate bonds under their Secondary Market Corporate Credit Facility, and would in turn follow a diversified market index of U.S. corporate bonds (wider variety of purchases). The purchases to date through the program have only bought ETF's and have not yet transacted in individual corporate bonds. The Dollar index slipped below the 96.75 level as investors rotated back into safe haven currency assets. Yields were little changed on the day, but moved off of their lows to close at 0.718% after touching 0.65%.



Source: Bloomberg as of 06.17.2020

Monday night Chinese authorities announced they shut down parts of Beijing after reporting 79 new Coronavirus infections tied to a meat and vegetable market. The confirmed cases are the highest total cases the country has reported in two months. In the U.S., several states continue to report increased Coronavirus infections from over the weekend including Arizona, Florida and Texas, which are among those on the forefront of easing restrictions. However, even as cases increased 0.9% through Sunday to 2.1M, the growth rate was lower than the average daily increase of 1.1% over the past seven days.

Europe - The Euro STOXX Index was down 6.44% last week, halting the recent rally.



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The European Central Bank urged Italy to use the proposed $844B stimulus to accelerate structural reforms. Italian Prime Minister Giuseppe Conte started strategy meetings with ministers and business leaders in closed-doors sessions to formulate a plan for the economic recovery. Italian stocks were down 6.44% last week.

In Germany, the government plans to raise an additional $62.5B in debt to fund their stimulus program. This proposal would bring national debt to 77% of the GDP. The DAX Index was down 6.99% last week.

France announced a $17B stimulus package for the aerospace industry. Finance Minister Bruno Le Maire warned that 100,000 jobs are at risk and that it may take up to three years to fully recover from the economic impact of the pandemic. The CAC 40 Index was down 6.90% last week.

In the United Kingdom, the property website operator Rightmove PLC reported a 1.9% increase in house prices this month following lockdown easing. Miles Shipside, director of the site, said that “buyers may now be trying to exchange quickly, as there are signs of high pent-up demand and upwards price pressure, rather than downwards.” The British real estate sector was down 6.26% last week.

APAC - China’s government announced at a political meeting its plan to sell $140B of special bonds by the end of July. The maturity ranges from five- to 10-year. The Shanghai Composite was down 0.38% last week, while the Hang Seng Index decreased 1.89%.

In Japan, the Parliament passed a $298B extra budget to boost the economic recovery. The bill aims to provide payroll subsidies, financing relief for distressed companies and aid to the medical system. S&P Global revised down the outlook for Japan from positive to stable. The Nikkei 225 decreased 2.44% last week.

In South Korea, the President is trying to de-escalate tensions with North Korea, as Kim Yo Jong warned of possible military action over the weekend. North Korea is accusing Seoul of allowing activists to float balloons carrying anti-Pyongyang messages across the border. The KOSPI Index was down 2.27% last week.

In India, May trade data shows minor improvement compared to April despite a 36.5% contraction in exports year-over-year. Imports declined 51% during the same period. For the first week of June, India’s exports were $4.94B, versus $5.03B last year during the same period. Indian stocks were down 1.48% last week.

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