Level Four Capital Management

WEEKLY INSIGHT

MARKET COMMENTARY

LAST WEEK

Major U.S. indexes pulled back and closed on the lows of the week amid concerns of a second wave of COVID-19 as multiple states reported record new cases, causing uncertainty that the economic recovery could falter. The S&P was lower by 2.85%, while the Dow Jones and Nasdaq closed down 3.30% and 1.89%, respectively. All sectors in the S&P ended lower on the week and were led to the downside by Energy, Financials, Communication Services, Industrials, REITs, Consumer Staples and Utilities, all which lagged the broader market. Growth again outperformed Value as the S&P Pure Growth Index fell 3.19% on the week while the S&P Pure Value Index fell 6%.

Source: Bloomberg as of 07.01.2020

Source: Bloomberg as of 07.01.2020

Energy was the major underperformer, falling 6.45% as crude sold off to settle down 3.2% on concerns surrounding demand growth. Financials experienced weakness on the back of banks (the Nasdaq Bank Index closed down 8.4% and fell 5% on Friday) after regulators required banks to suspend buybacks through the 3Q and cap dividend payments based on historical net income numbers. While the stress tests yielded few surprises, the negative announcement regarding capital programs overshadowed positive news with the loosening of some Volcker rule restrictions. The Communication Services sector lagged with internet companies being the primary drag, in particular Facebook (-9.5%), as major corporations paused their ad spending on the social media platform.

Stocks pegged to the re-opening while the economy stumbled and underperformed due to those who are tied to the stay-at home narrative. Airlines weighed on Industrials, and Restaurants weighed on Consumer Discretionary despite the latter sector being a relative outperformer with help from select retailers. Technology was the best performing sector again with Large Tech providing leadership to the upside (Apple +1.1%, Amazon +0.7%, Microsoft +0.6%). Treasuries were stronger across the curve with the curve flattening slightly as the spread between the 10-year Treasury and 2-year Treasury fell about 3bps on the week to 47.5bps. Gold finished higher by 1.6% and the USD was weaker against the Yen over the five days as investors looked to take risk off the table.

The major theme throughout the week focused on a spike in Coronavirus cases. Despite national averages staying relatively in-line with previous weeks, a lot of attention remained on southern and western states who are seeing a number of new cases. Headlines were negative leaning again throughout the week and came as the Trump administration stressed that the resurgence of cases is primarily due to expanded testing, and was not due to a second outbreak. Even as positive COVID-19 cases increase, we continue to see a declining death rate. However, in the end, that did little to support investor sentiment and stories throughout the week included:

- ICU occupancy in Houston hitting 100% of its nominal capacity (despite COVID-19 cases only accounting for 27% of capacity)
- Texas Governor Greg Abbott signing an executive order suspending elective surgeries in four of the state's largest counties in order to ensure ample bed space
- Friday's announcement in which Greg Abbott issued an executive order to re-close bars and certain restaurants. Florida officials also announced they would shut down all bars within the state shortly thereafter.
- New York, Connecticut and New Jersey announcing that new visitors from states experiencing an outbreak in cases would need to self-quarantine
- Bloomberg news reporting that the European Union (EU) is moving toward recommending a ban on the entry of U.S. travelers, potentially as early as July 1st

Gaining less traction and attention were the positive headlines which included:

- Several of the hardest-hit states are still experiencing a decline in new cases
- New hotspot states may not represent a large enough percent of U.S. GDP that would put the economic recovery at risk and the current restrictions are not as extreme as previously seen
- The potential for a generous stimulus package in July if cases continue to increase

Also flaring up briefly this week were concerns regarding the U.S./China trade relationship. While the tensions between the two countries have recently taken a backseat to the Coronavirus pandemic, investors were reminded that tensions have not completely abated. The tensions resurfaced after White House Trade Representative Peter Navarro said that the deal is "over", referring to the highly touted Phase 1 trade agreement. President Trump walked back his advisor's comments shortly after they were made, tweeting that the agreement was "fully intact". Additionally, according to the Wall Street Journal, Chinese officials have reportedly suggested it is becoming increasingly difficult to justify large purchases of agricultural goods as tensions remain elevated.

As we inch towards November, markets continue to slowly shift their attention towards the campaign trail and potential election results. While it is not new to anyone that Biden has led Trump in multiple national polls recently, it is worth noting that several large, national polls this week showed the former Vice President's lead over President Trump has increased. According to a New York Times/Siena poll the results showed a 14-point lead for Biden. Furthermore, state specific polls showed that Biden now leads Trump in several important swing states that Trump captured during the 2016 election including:

- Wisconsin
- North Carolina
- Arizona
- Michigan
- Florida
- Pennsylvania

While there is still plenty of time between now and the election, the President's approval ratings have tumbled in recent weeks over his handling of the Coronavirus pandemic and ongoing civil unrest. According to a poll conducted by CBS News and YouGov, a mere 41% approve of the President's handling of the pandemic, which is down from 52% in March. The results seem to echo a similar sentiment from other polls conducted by Reuters, CNBC and Harris, where just 38% of respondents have said they approve of the handling of the Coronavirus.

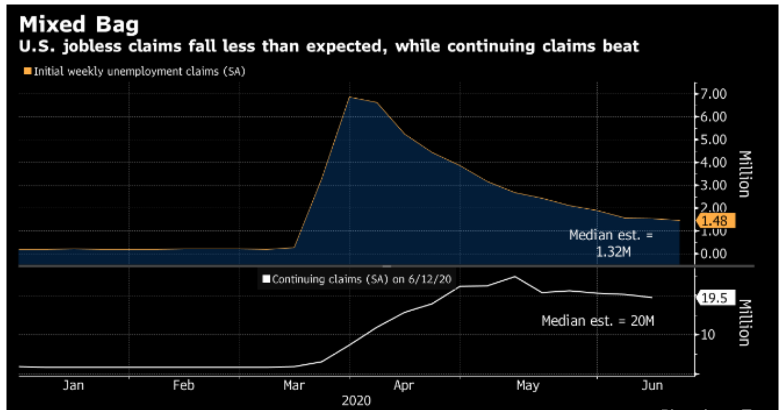
Economic data released throughout the week did little to offer confidence or provide a clear direction for investors and included the following:

- Initial jobless claims missed expectations again (second straight week)
- Continuing claims fell to 19.522M, declining more than expected
- Existing home sales during May disappointed and fell more than anticipated
- New home sales beat expectations

With the mixed results, there was some talk about how the Fed has only injected a small portion of their promised support and that there is still plenty of room for the Central Bank to act as needed.

The Commodity Futures Trading Commission (CFTC) published the Commitment of Traders (COT) report showing futures positions as of Tuesday's close. The following highlights the report's findings and the speculative positioning:

- FX: The aggregate Dollar short rose by around $1.3 billion as investors sold Dollars against almost every currency on our board except the Pound (GBP) and Swiss Franc (CHF). Flows were most pronounced against the Japanese Yen (JPY) and Canadian Dollar (CAD)
- Equities: The big SPX e-mini short shrank dramatically, with net buying of 206K contracts, with shorts now standing at 97K. Elsewhere: Notable buyers of commodities, adding to longs in Gold, Crude, and Copper



Source: Bloomberg as of 07.01.2020

THIS WEEK

U.S. equities rallied on Monday with major indexes all closing up over ~1%, helping to recover some of Friday's losses. The Dow led the way higher, finishing up 2.32% after its largest component Boeing closed up 14.4% on positive recertification tests of their 737 Max. The S&P 500 posted a 1.47% gain followed by the Tech-heavy Nasdaq which closed up 1.20%. It was a very quiet day to start the shortened holiday week with U.S. equity volumes standing at just 10.8B on Monday, while the year-to-date average stands at 13.2B. All 11 sectors in the S&P closed in the green led by Industrials, Communication Services, and Materials.

Treasuries were little changed despite the move higher in stocks, as the 10-year finished flat and the 30-year gained less than 1bps to close at 1.3734. The move in equity markets came from positive leaning COVID-19 headlines (see below for more details) and better-than-expected housing data as May pending home sales in the U.S. jumped the most on record, increasing 44.3% to a three month high after falling in April to the lowest level dating back to 2001.

SPX

As the risk-on tone gripped Monday's session, many of the names most affected by the Coronavirus outperformed broader markets (Airlines, Restaurants, Retailers, Hotels). The bounce came as COVID-19 headlines leaned more positive as investors remain extremely skittish, with sentiment changing on what feels like a minute by minute basis. With volatility hovering around the year to date average (32.74), this year has actually seen higher realized volatility (46) than 2008 (41) and any other year dating back to 1986 according to Cornerstone Macro.

Source: Bloomberg as of 07.01.2020

Throughout the day, the following headlines emerged providing investors with some optimism and overshadowed the negative headline out of New Jersey after Government Murphy said he would pause the state's plans to restart indoor dining on July 2nd.

- Florida COVID-19 cases rose 3.7% in Florida versus the 7-day average of 5.5%
- Arizona posted its lowest case increase since May 31st
- California cases rose 2.5% versus the 7-day average of 2.8%

With the move higher, major averages remain on track to post their largest quarterly gain since 1998. Just as we saw at the end of Q1 with rebalance flows into equity markets to shore up asset allocations, Q2 expectations call for outflows of around ~$70B in equities. While we do not anticipate this being a major market moving catalyst in the long-term, we would not be shocked to see some added market volatility over the course of the already quieter holiday week.

SPX Index | 95) Datasets | 96) View | 97) Edit | Seasonality Chart
Last Price | USD | Spread | <Type security> | Last Price | High/Low/Avg
15 Years Ending 2020 | Percent Change | Net Change
Calendar Year | Trailing 12M | 01-Jan - 31-Dec | Monthly | Line | Heat Map | « | Securities/Lines | Map Options

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
15 Yr Avg	-.12	.58	1.68	1.99	-.19	-.49	1.94	-.40	.53	.46	1.02	.51
2020	-.16	-8.41	-12.51	12.68	4.53	.29						
2019	7.87	2.97	1.79	3.93	-6.58	6.89	1.31	-1.81	1.72	2.04	3.40	2.86
2018	5.62	-3.89	-2.69	.27	2.16	.48	3.60	3.03	.43	-6.94	1.79	-9.18
2017	1.79	3.72	-.04	.91	1.16	.48	1.93	.05	1.93	2.22	2.81	.98
2016	-5.07	-.41	6.60	.27	1.53	.09	3.56	-.12	-.12	-1.94	3.42	1.82
2015	-3.10	5.49	-1.74	.85	1.05	-2.10	1.97	-6.26	-2.64	8.30	.05	-1.75
2014	-3.56	4.31	.69	.62	2.10	1.91	-1.51	3.77	-1.55	2.32	2.45	-.42
2013	5.04	1.11	3.60	1.81	2.08	-1.50	4.95	-3.13	2.97	4.46	2.80	2.36
2012	4.36	4.06	3.13	-.75	-6.27	3.96	1.26	1.98	2.42	-1.98	.28	.71
2011	2.26	3.20	-.10	2.85	-1.35	-1.83	-2.15	-5.68	-7.18	10.77	-.51	.85
2010	-3.70	2.85	5.88	1.48	-8.20	-5.39	6.88	-4.74	8.76	3.69	-.23	6.53
2009	-8.57	-10.99	8.54	9.39	5.31	.02	7.41	3.36	3.57	-1.98	5.74	1.78
2008	-6.12	-3.48	-.60	4.75	1.07	-8.60	-.99	1.22	-9.08	-16.94	-7.48	.78
2007	1.41	-2.18	1.00	4.33	3.25	-1.78	-3.20	1.29	3.58	1.48	-4.40	-.86
2006	2.55	.04	1.11	1.22	-3.09	.01	.51	2.13	2.46	3.15	1.65	1.26
2005	-2.53	1.89	-1.91	-2.01	3.00	-.01	3.60	-1.12	.69	-1.77	3.52	-.10

-16.94 | 12.68

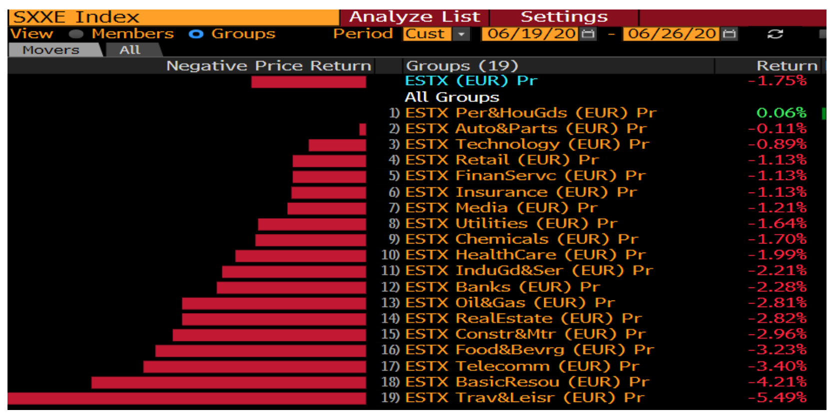
Source: Bloomberg as of 07.01.2020

THIS WEEK INTERNATIONAL

Europe - After weeks of speculation, Bank of France governor hinted that there is a low probability that the European Central Bank (ECB) starts buying junk bonds as part of the pandemic emergency program. In an interview published on Sunday, he said "I rule out that we buy bonds that were rated junk before the crisis. On the other hand, if rating agencies downgrade well-rated companies during the crisis, this can reinforce an already negative trend."

ECB board member Isabel Schnabel warned that inflation could remain close to 0% and negative territory "well into next year". She added, "it would go against the very idea behind the common currency if we were to stand idly by and watch the pandemic carve a rift into the Euro area and produce deep divisions that would endanger the return to a single monetary policy in the long run."

The Euro STOXX Index was down 1.75% last week, travel and leisure dropped 5.49%.



Source: Bloomberg as of 07.01.2020

A German parliamentary coalition agreed on a draft motion to support ECB's bond-buying program. Germany's constitutional court ruled in May that this program could be illegal. This motion will probably put an end to the legal battle between the ECB and Germany's top court.

APAC - The People's Bank of China (PBOC) announced in its last meeting on June 24th that more liquidity support will be granted to small companies and manufacturing companies to boost the real economy. This will translate into lower lending rates and accommodative monetary policy going forward. The Shanghai Composite Index was up 0.40% last week.

In Japan, the trade ministry reported that retail sales rose 2.1% in May, below the 3% consensus estimate. Non-essential retail stores re-opened in late May, right after the state of emergency was lifted. The Nikkei 225 gained 0.15% last week.

The South Korean Finance Minister does not plan to submit an additional budget proposal this year in parliament. According to the Minister, the economic impact from the pandemic may have bottomed, as shown by better consumption and export data. The KOSPI Index was down 0.31% last week.

IMPORTANT DISCLOSURES

The information provided, including any tools, services, strategies, methodologies and opinions, is expressed as of the date hereof and is subject to change. Level Four Capital Management ("LFCM") assumes no obligation to update or otherwise revise these materials. The information presented in this document has been obtained from or based upon sources believed by the trader or sales personnel or product specialist to be reliable, but LFCM does not represent or warrant its accuracy or completeness and is not responsible for losses or damages arising out of errors, omissions or changes or from the use of information presented in this document. This material does not purport to contain all of the information that an interested party may desire and, in fact, provides only a limited view. Any headings are for convenience of reference only and shall not be deemed to modify or influence the interpretation of the information contained.

This material has been prepared by personnel of LFCM and is not investment research or a research recommendation, as it does not constitute substantive research or analysis. This document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would subject LFCM to any registration or licensing requirement within such jurisdiction. It is provided for informational purposes, is intended for your use only, and does not constitute an invitation or offer to subscribe for or purchase any of the products or services mentioned, and must not be forwarded or shared with retail customers or the public. The information provided is not intended to provide a sufficient basis on which to make an investment decision. It is intended only to provide observations and views of certain LFCM personnel. Observations and views expressed herein may be changed by the personnel at any time without notice.

Nothing in this document constitutes investment, legal, accounting or tax advice or a representation that any investment strategy or service is suitable or appropriate to your individual circumstances. This document is not to be relied upon in substitution for the exercise of independent judgment. This document is not to be reproduced, in whole or part, without the written consent of LFCM.