Level Four Capital Management

WEEKLY INSIGHT

HIGHLIGHTS

- Major averages closed slightly lower last week, after the S&P and Nasdaq declined in three straight sessions on Wednesday, Thursday and Friday, causing indices to post their third straight weekly decline, something not seen since March.
- The Merrill Lynch Fang Index lagged broader markets, falling 4.26% on the week as Mega Cap Tech-related names bared the brunt of selling pressures.
- Early in the week M&A activity was the main driver behind the risk-on tone in Monday and Tuesday's sessions with over ~50B worth of deals being announced.
- Seven of 11 sectors finished in the red. Energy was the best performing sector reversing two weeks of being the worst performing space. The gain of 2.90% in the sector came as OPEC+ continued to urge compliance of the agreed upon supply cuts for the group and Hurricane related production cuts in the US. WTI crude gained 9.4% over the week.
- After the Fed concluded it's two-day meeting, they signaled the potential rates to remain extremely dovish with rates expected to remain near 0% until at least 2023.
- The Central Bank will remain in an accommodative Monetary stance policy, using any tools they are expected to continue support the ongoing economic recovery. Asset purchases will remain unchanged and it is anticipated that the Central Bank will likely buy at least $80B of Treasuries and $40B of Mortgage Backed Securities a month.
- Commentary from JP Morgan, Bank of America, Citigroup & PNC Financial Services executives showed that loan demand remains weak and could pressure Net Interest Margins (NIM) in the near future.
- According to JP Morgan, around ~$200B will need to flow out of equities as part of 3Q rebalancing in order to bring portfolio weights in line after the run higher in equity markets.
- Healthcare was one of the worst performing sectors on Monday, September 21st following Ruth Bader Ginsberg's death as the Trump administration is set to challenge the Affordable Care Act (ACA) on November 10th.
- In Japan, the ruling party elected Yoshihide Suga as the new Prime Minister of Japan. The Liberal Democratic Party leader is expected to follow the path of his predecessor Shinzo Abe, known for the extensive use of Quantitative Easing to spur growth and fight secular deflation. The Nikkei 225 was down 0.20% last week, with materials lagging the index.

MARKET COMMENTARY

LAST WEEK

Domestic equities finished slightly lower on the week after the S&P, Nasdaq, and Dow all closed lower, posting their third straight week of declines, something investors have not experienced since March. The Merrill Lynch FANG index was the notable underperformer, losing 4.26% over the five days after all members declined at least ~2.5% (Netflix was the best performer), with most constituents falling more than 4%. The move lower came as Europe looked to be battling a potential resurgence of COVID-19 cases, with multiple countries reporting their highest number of cases in months. S&P 500 Value outpaced momentum and growth once again, with value gaining 1.70% while momentum added a mere 23bps as the risk-off tone gripped markets in the

Source: Bloomberg as of 09.22.2020

latter part of the week. Even in spite of the broader selloff, the VIX remained largely unchanged while S&P 500 equity funds witnessed a "buy the dip mentality" with investors seeing inflows into the space with the three largest ETF's bringing in around ~$8B, led by iShares ($4.3B), SPY (~$2B) and Vanguard 500 Index (~ $1.7B) according to GTS Mischler.

M&A activity was a big driver behind the risk-on tone initially seen during Monday and Tuesday's sessions, with multiple deals being announced throughout the week.

- **MetLife (MET)** announced they would acquire Versant Health for $1.675B in cash
- **51Job Inc (JOBS)** announced an offer from PE firm DCP Capital Partners to be taken private for $79.05/share or $5.3B
- **Gilead (GILD)** buying Immunomedics (IMMU) for $21B
- **Nvidia (NVDA)** agreed to buy ARM Holdings from Softbank for $40B
- **Merck (MRK)** said they will take a $1B stake in Seattle Genetics, with the potential to buy up to $4.5B
- **Oracle (ORCL)** agreed to partner with ByteDance for TikTok's U.S. operations
- **Verizon (VZ)** announced they are buying Tracfone Wireless for up to $6.9B

Source: Bloomberg as of 09.22.2020

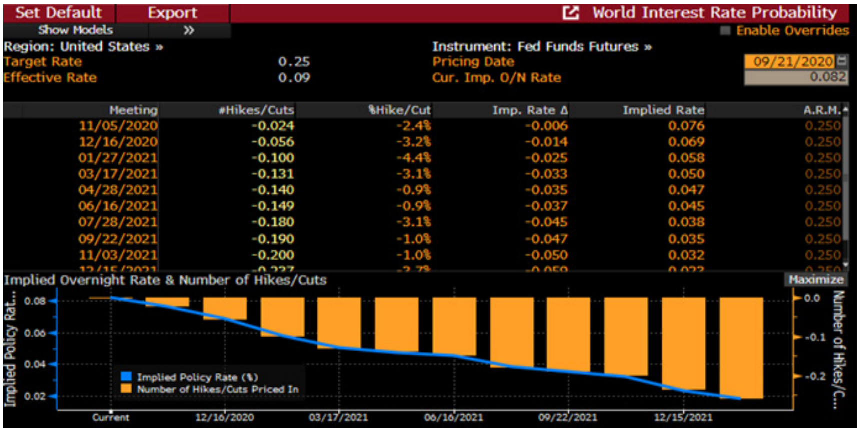
However, early week optimism faded and most sectors fell with seven of the 11 ending in the red. Energy reversed course from what was seen the prior two weeks and finished as the best performing sector with outsized gains seen in E&P and refining companies. The gains came after WTI crude rallied 9.4% during the week amid hurricane related production curbs, along with OPEC+ urging countries within the cartel to comply with supply quotas that reflect the previously agreed upon production cuts. Industrials were another bright spot as the space gained 1.52% over the week with strength in airlines and machinery-related names. Healthcare closed up 0.84% with biotech and pharma outperforming, benefiting from a number of M&A deals announced. Technology-related companies fell with weakness in mega cap names, and Consumer Discretionary lagged (worst performer) as cruise lines, gaming, and heavyweight Amazon led gains to the downside. Treasuries were largely unchanged as the curve steepened slightly, with the 10-year gaining just under 3bps and remaining range-bound.

Although Financials outpaced broader indices during the week, top U.S. banks warned that revenues could be lower due to softer loan demand and an uptick in repayments. With the Fed issuing some forward rate guidance and a dovish outlook, investor concerns surrounding Net Interest Margin (NIM) pressure started to emerge. According to an article released by Reuters, Bank of America's loan balances dipped below pre-pandemic levels, potentially setting up a decline in their loan book for the first time since 2015. The bank cut their NIM revenue estimates by roughly $400M, while JP Morgan announced that they slashed theirs by $1B. Citigroup and PNC executives also echoed similar comments saying less consumer borrowing could be the primary reason 3Q revenues would fall. Adding to these headwinds was intelligence from S&P Global that forecasted the 10 largest U.S. Banks combined could see an annual decline of more than $7B in revenues due to Joe Biden's tax hike proposal, taking rates from current levels to 28%.

Following the conclusion of the September Fed meeting, the Central Bank remained dovish, setting the bar high for the group to raise rates. The Central Bank signaled they "expect to maintain an accommodative stance of monetary policy" and that they remain committed to using their full range of tools to support the ongoing economic recovery, as they look to potentially leave rates unchanged through 2023 (though four officials have at least one hike penciled in during 2023).

In order to raise rates, three conditions would need to be met from their standpoint, which include:

1. Unemployment reaches "levels consistent with the Committee's assessment of maximum employment"
2. Inflation (as measured by PCE) "has risen to 2%"
3. Inflation "is on track to moderately exceed 2% for some time"

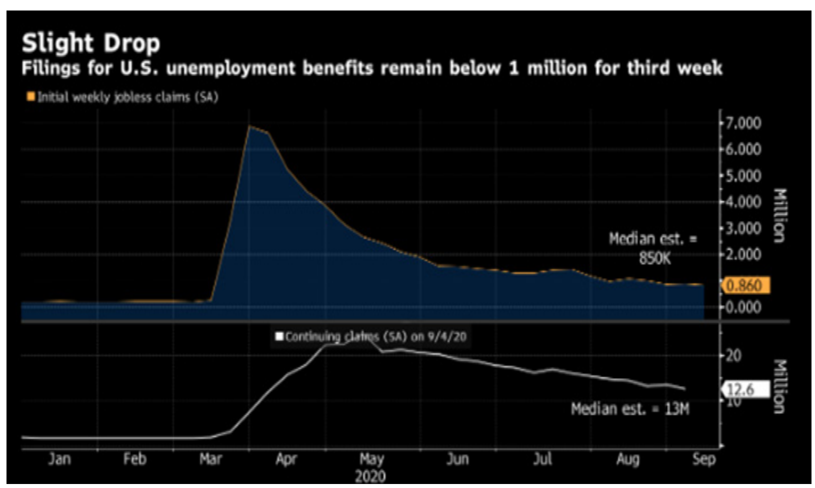


Source: Bloomberg as of 09.22.2020

Additionally, while their statement surrounding Quantitative Easing changed, they did not tweak the size of the asset purchase program, leaving it at the current pace of $80B worth of Treasuries, and another $40B worth of mortgage backed securities. Chairman Powell and other Fed officials continued to stress that the U.S. recovery is highly correlated to the nation's ability to better control the virus and that additional fiscal stimulus is likely needed to help support the labor market and household incomes.

Another week has come and gone with no progress being made on the political front regarding another stimulus deal, which as of writing this, remains elusive. Investors continue to gear up for the likelihood that Congress will not have the time or drive to pass an additional fiscal stimulus bill ahead of the Presidential election as Democrats and Republicans continue to remain at odds with one another on key components of a fifth Coronavirus relief bill. Democrats continue to push for a $2T package, while Republicans have been very reluctant to go above their "skinny deal" worth around ~1T, which they have currently proposed. With Congress set to go on recess in early October and not return until after the election, hopes of the two sides coming together continue to dwindle, potentially putting additional pressure on household incomes.

There was a flurry of economic data released throughout the week, however it did little to change market sentiment one way or another. Retail sales missed expectations, gaining 0.6% versus a consensus of 1.0%, with food services contributing to most of the gain in the headline number. Other releases included homebuilder confidence, measured by the NAHB homebuyer index, which topped estimates and posted its strongest levels on record. Initial jobless claims, although missing expectations by 10K (860K vs 850K), declined on a week-over-week basis and continued its trend lower, staying below 1M for a third straight week, while continuing claims also continued its downtrend and came in ahead of estimates.



Source: Bloomberg as of 09.22.2020

Overall, there was not much to move the needle in terms of a shift in sentiment. While broader indices did pull back throughout the week as multiple headwinds persist, the selloff appeared to be calm and orderly with volumes remaining lackluster at best. Friday's session was the only one that saw outsized volumes resulting in elevated volumes levels due to both Quad witching (stock index futures, stock index options, single stock options and single stop futures all expire on the same day), and broader index rebalances (S&P 500 and Russell). As we approach the end of 3Q, rebalancing estimates are anticipated to be around ~200B to sell according to JP Morgan who said on Thursday that funds will need to sell that amount in order to bring portfolios back in line after the move higher in equities over the course of the quarter.

THIS WEEK

Source: Bloomberg as of 09.22.2020

On Monday, the week started out in rough fashion with a sea of red taking over investor's screens. The Nasdaq & S&P 500 fell to their lowest levels since late July and declined for a fourth consecutive session amid ongoing fears of a potential second wave of COVID-19. Ten of the 11 sectors fell, with Tech being the only one to buck broader selling pressures and finish in the green, rallying off session lows and into the close. The rally on Monday started right before 3pm and added 1.48% on the S&P, to close down 1.16%, while the Nasdaq gained 181 points or 1.71% over the last hour and 15 minutes of trading. The sell-off came as European countries continue to assess the re-implementation of lockdowns amid a resurgence in COVID-19 case.

Several other factors weighed on markets worldwide including:

- Stalemate in Congress over another stimulus bill
- Headline that global banks processed over $2T of allegedly illegal money laundering funds from some of the world's most dangerous and powerful criminal networks ranging from 1999-2017 according to International Consortium of Investigative Journalists
- The potential replacement of Supreme Court Justice Ruth Bader Ginsburg (this particularly weighed on Healthcare)
- Oil reversing last week's gains and fell 3.55%
- Tik Tok and Oracle continuing to struggle over the ownership structure for the new U.S. based-version of the company, bringing into focus the fragility of the deal

The stay-at-home trade rotated back into favor today travel, leisure, retail and hospitality names were some of the hardest hit. Stay-at-home beneficiaries were among the top performers (Peloton, Zoom, Netflix, Electronic Sports, Roku) in Monday's session even as the S&P fell more than 900 points at its lows, the worst intra-day decline for the index since April 1st when it declined 973 points (4.4%).

Ticker		Last Price	Net	%1D	Ind Subgroup
UNH US		299.19c	-8.83	-2.87%	Medical-HMO
MOH US	S	168.88c	-15.68	-8.50%	Medical-HMO
CNC US		55.99c	-5.14	-8.41%	Medical-HMO
HUM US		394.51c	-8.12	-2.02%	Medical-HMO
ANTM US		257.71c	-6.48	-2.45%	Medical-HMO
THC US	S	24.52c	-3.71	-13.14%	Medical-Hospitals
HCA US		125.45c	-6.80	-5.14%	Medical-Hospitals
UHS US	S	107.84c	-10.09	-8.56%	Medical-Hospitals
CYH US	S	4.21c	-0.27	-6.03%	Medical-Hospitals
CI US		164.96c	-2.96	-1.76%	Pharmacy Services

Source: Bloomberg as of 09.22.2020

Gaining traction on Monday was President Trump's announcement that he expects to finalize Supreme Court Justice Ruth Bader Ginsburg's replacement by Friday or Saturday. The President is said to be choosing from five female Supreme Court candidates, in what is almost certain to be a controversial move ahead of the November election. Healthcare and managed care names in particular were among some the hardest hit in the Healthcare sector, having their worst day in months following Ruth Bader Ginsburg's death. This is in part related to the fact that the Trump administration is set to challenge Obamacare before the Supreme Court on November 10th, with a final ruling expected in the first half of next year. The challenge to Obamacare could revitalize Democratic momentum and increase turnout in both the Senate and Presidential elections, bringing into focus Biden's proposal to lower the Medicare age qualification. With the potential lowering of Medicare eligibility, hospitals could face revenue pressures as reimbursement rates decline. Additionally, while the Affordable Care Act supplies more than 20M people with health coverage, a ruling in favor of the Trump administration could also pressure health insurers who primarily benefit from listing on insurance exchanges.

THIS WEEK INTERNATIONAL

Last week, global equities were back in the green after two consecutive down weeks. The MSCI ACWI Index was up 0.19%, led by Health Care, up 1.8%. Industrials and Materials kept their momentum with another strong week. Information Technology remained in the red and is now trading 0.67% below the 50-day moving average. The Bloomberg global annual GDP growth survey median currently stands at -3.9%, while the Bloomberg global CPI forecast stands at 2.3% versus 3% a year ago.

Source: Bloomberg as of 09.22.2020

Europe: The European Central Bank (ECB) launched a review of the Pandemic Bond-Buying Program to evaluate whether the program should be extended and the conditions of a potential extension. The Bundesbank President Jens Weidmann voiced his concern about the risk of monetary financing of governments, which is not authorized under European Union Law. Meanwhile, ECB's balance sheet continues to gradually grow and make new highs. Indeed, as of September 11th, ECB's balance sheet stood at €6.474 trillion.

The Euro STOXX Index was down 0.46% last week, as the fear of a second wave of infection and travel restrictions continues to shake the markets. The health care sector gained 1.89%, while real estate and banks were down 1.42% and 4.44% respectively. All major European indices were correlated with the S&P 500 sell-off. The DAX index was down 0.66%, while the CAC 40 Index slid 1.11% and the Amsterdam Exchange was down 0.21%.

The European Union granted banks in the bloc a temporary access to derivatives clearinghouse in Britain up to 18 months after Brexit. The Bank of England commented that it is "an important step to mitigate financial stability risks around the end of the year". The FTSE UK implied volatility slightly decreased from 23.24 to 22.38 last week.

Brussels reacted to Boris Johnson's unilateral changes to the withdrawal agreement and said that they will "not be shy" to take legal actions against the UK to address violations of the Agreement. These tensions put in jeopardy the ongoing trade deal negotiations between both parties. The FTSE All-share index was down 0.29% last week, with banks down 5.08%.

APAC: China conducted aerial military exercises near Taiwan amid a U.S. diplomatic visit to Taiwan. Colonel Ren Guoqiang, a spokesman of China's defense ministry said that the drills were "in response to the current situation and designed to safeguard China's national sovereignty". He also accused Taiwan and the U.S. of "stepping up collusion, frequently causing disturbances" and warned that "those who play with fire will be burned". The Trump administration is negotiating a multibillion-dollar sale of weapon that could help Taiwan protect itself from Beijing. The Shanghai Composite Index was up 2.38%, led by real estate, up 3.96%. However, the Hang Seng Index was down 0.20%, with utilities down 0.78%.

In Japan, the ruling party elected Yoshihide Suga as the new Prime Minister of Japan. The Liberal Democratic Party leader is expected to follow the path of his predecessor Shinzo Abe, known for the extensive use of quantitative easing to spur growth and fight secular deflation. The Nikkei 225 was down 0.20% last week, with materials lagging the index.

Bank of Japan (BOJ) held a policy meeting last week that was highly anticipated by market participants. The BOJ left short-term rates unchanged at -0.10% and maintained its target for the 10-year JGB yield around 0%. The priority remains to provide support to corporations, even though Kuroda did not announce additional monetary stimulus. The Yen gained 1.49% versus the U.S. Dollar last week.

Emerging Markets: The Brazilian Central Bank maintained its benchmark interest rate at 2% last week amid strong economic data. In fact, industrial production and retail sales rebounded strongly in the last two months, helped by government spending and a slight increase in demand. The Central Bank announced that it "does not intend to reduce monetary stimulus unless inflation expectations, as well as its baseline scenario inflation projections, are sufficiently close to the inflation target." Policy makers project 4% inflation this year and 3.75% next year. Brazilian stocks decreased 0.07% last week.

In South Korea, preliminary trade data show a possible turning point in global demand. Indeed, according to Customs Office and Bloomberg, exports for the first 20 days of September grew 3.6% from a year earlier. Additionally, exports to China, which is South Korea's biggest market, rose 8.7%. Looking at the items in high demand, semiconductors stood out with a 25% increase in export during the same period. On the other hand, Korean imports decreased 6.8% during the same period. The KOSPI Index was up 0.66% last week, led by transport and storage, up 5.96%. Chemicals were down 1.76%.

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