Level Four Capital Management

WEEKLY INSIGHT

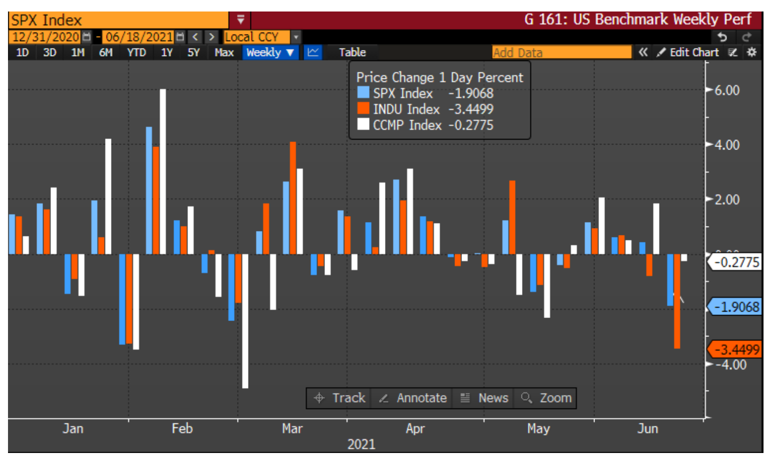
HIGHLIGHTS

- The S&P 500 logged its worst weekly decline since February, with Friday's pullback of 1.31% being the single-worst session for the index since May 12th.
- Treasuries flattened on the week as yields fell on the long end of the curve with the 10-year yield dropping back to 1.43%.
- Focus surrounded the Central Bank's release of a more-hawkish dot plot and commentary, which now called for two 25bps hikes by the end of 2023, in contrast to the one 25bps hike by the end of that year.
- Although no action was taken at the meeting to adjust policy, Fed Chair Jerome Powell continued to downplay the move in the Feds dot plot, saying it "should be taken with a big grain of salt".
- The less dovish commentary took some investors by surprise and halted the reflation trade as growth outperformed value on the week. Tech was the only sector to finish higher on the week.
- Regional banks were some of the largest losers as loan margins would be compressed with the move lower in yields. KRE saw $932M in inflows after the Fed statement on Wednesday, followed by $787M in outflows Friday.
- Gold suffered its worst week in 15 months as the dollar surged, sending the commodity tumbling more than 5% through its 100-day moving average.
- In China, policy makers organized a meeting with top banks and fintech companies to reinforce a ban on cryptocurrency services.
- In Japan, the BOJ decided to leave interest rates unchanged at the last meeting while extending its COVID-19 support program for small businesses.
- In Brazil, the Central Bank lifted its benchmark interest rate last week by 75bps to 4.25% amid surging inflation expectations.

MARKET COMMENTARY

LAST WEEK

U.S. equities finished broadly lower on the week, led to the downside by the Russell 2K, which declined 4.20%. The S&P 500 logged its worst weekly decline since February, with Friday's pullback of 1.31% being the single-worst session for the index since May 12th. Although ending lower, the NASDAQ outperformed broader U.S. benchmarks, closing down 0.28% as growth outperformed value in a meaningful way after an unexpectedly hawkish Fed meeting.



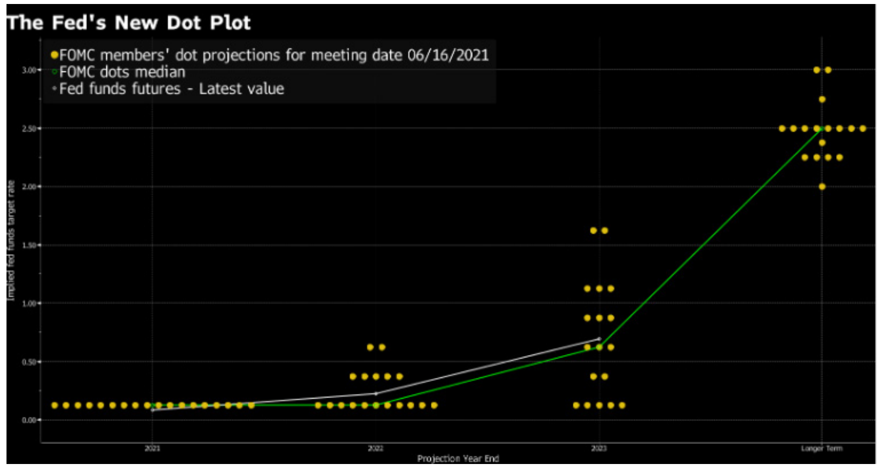
Source: Bloomberg as of 06.23.21

Treasuries flattened on the week as yields fell on the long end of the curve with the 10-year yield dropping back to 1.43% and the 30-year falling below 2% for the first time since February. The drop-in rates came amid speculation that the Federal Reserve will tighten sooner rather than later as inflationary pressures continue. The U.S. dollar ended higher, capping its best week since September of 2020, while Gold fell 5.9% registering losses in six straight days, making it the worst week since March 2020. The safe-haven asset posted back-to-back declines of ~2% on Wednesday and Thursday.

Source: Bloomberg as of 06.23.21

FEDERAL RESERVE MEETING AND COMMENTARY

Most of the action revolved around the June Federal Open Market Committee (FOMC) meeting and its future outlook regarding economic projections. Investors saw the Central Bank release a more-hawkish dot plot and commentary about upcoming actions that could be taken, including the tapering of the existing bond-buying program. The announcement, which made no changes to the current rate policy or its $120B/month asset-purchase program, showed the future median policymaker expectation is for two 25bps hikes by year-end 2023, in contrast to previous thoughts of just one in 2023. The change in future policy expectations came as 2021 GDP and inflation forecasts moved moderately higher as well.



Source: Bloomberg as of 06.23.21

Fed Chair Jerome Powell continued to downplay the move in the Feds dot plot, saying it is not a plan and that it should be "taken with a big grain of salt". Furthermore, he continued to reiterate that the group will remain highly accommodative and that the Feds' recent stance of continuing its asset purchase program will not change until they see "substantial further progress" towards inflation and price goals.

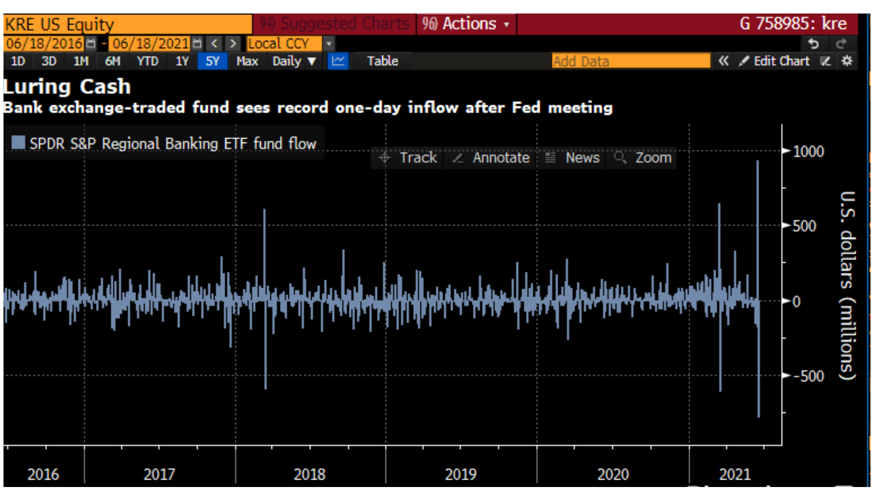
REFLATION TRADE LOSING STEAM

The less dovish commentary took some investors by surprise and halted the reflation trade, causing some to second-guess the future prospects of value sectors. Technology outperformed and was the only sector to finish in the green while all ten other sectors closed lower.

Economic data released on the week, all seemingly missed estimates including May retail sales, initial jobless claims, PPI, and housing starts, illustrating the economic rebound may be losing steam. Initial jobless claims rose by 37K and was the first weekly increase in the last six weeks according to the Labor Department. However, the slight move higher was likely a temporary blip for the labor market.

Value sectors and names related to the reflation trade were among the main laggards this week including:

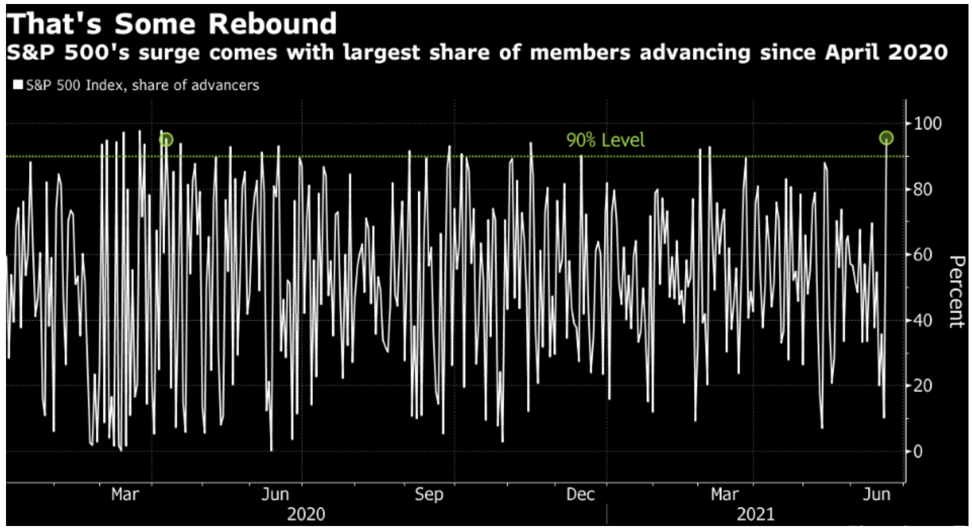
- Industrial and precious metals weighing on materials
- Financials, which declined with weakness in banks
- Energy dropped as oil service names fell (despite oil holding up)
- Industrials who underwhelmed with airlines underperforming



Regional banks were some of the largest losers as the bank's loan margins were compressed with the move lower in yields. On Wednesday, State Street's S&P Regional Banking ETF (KRE) notched its best day ever for new assets, after the more hawkish fed announcement as KRE raked in $932M. However, by the close Friday, the ETF had declined more than 8% over the following two sessions and reported its largest outflows in a single day in the last ten-years, as investors yanked about $787MM in Friday's session.

Source: Bloomberg as of 06.23.21

THIS WEEK



Source: Bloomberg as of 06.23.21

Domestic stock opened higher and melted up throughout the entire session; recouping half of last weeks losses as the VIX retreated 14% on the session. The Dow Jones Industrial jumped for the first time in six sessions while the S&P 500 posted its largest one-day move in over a month after previously posting its worst day since mid-May. 95% of equity members within the S&P 500 advanced in Monday's session; the third time this year the index had more than 90% of its members advance making it the largest share since April 8th of 2020.

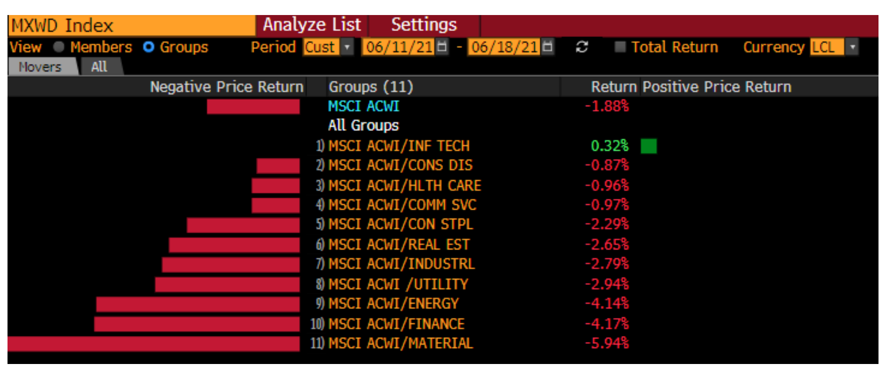
U.S. stocks rallied as investors calculated the Fed would remain on a gradual tightening path, taking things slower than they say, despite more hawkish rhetoric today, which was a continuation from last week. Dallas Fed President Robert Kaplan said he favors starting the process of tapering bond purchases "sooner rather than later". Additionally, St. Louis Federal Reserve officer James Bullard called it "appropriate" that the group kicked off discussions last week on reducing the rate of MBS purchases.

The focus this week should revolve around economic data releases and various Fed speak, with ten FOMC members speaking at 16+ events, including Chairman Jerome Powell who is set to testify to a House Panel on Tuesday.

Yields plunged lower with the ten-year touching a low of 1.36% on Sunday night, however, recovered to close up 5bps and settle at 1.488%. Oil and Energy names were the standout performers on the day jumping 2.71% and 4.29% respectively as Bank of America said "tighter supply and demand balances in 2022 could push oil briefly to $100 per barrel". Shares of EOG Resources, Hess, Marathon Oil Corporation, Apache and Diamondback Energy were among the top S&P 500 gainers. Bitcoin and other crypto asset names including Litecoin and Ethereum declined further following reports of additional regulatory measures in China as authorities ordered various cryptocurrency mining projects to shut down.

INTERNATIONAL

Last week, global equities dropped 1.88% as investors processed interest rates decisions from global Central Banks. Information technology was the only sector in the green, slowly recovering from the weakness endured in the first half of the year. Financials and materials suffered large weekly losses amid declining yields and a strengthening dollar. Near-term economic data will provide a fundamental base to the ongoing factor rotation as we witness volatility pick up in different markets.



Source: Bloomberg as of 06.23.21

EUROPE

The European Central Bank (ECB) governing council met last week to discuss the modernization of the institution with new inflation goals, new economic metrics, and new targets for topics such as climate change and inequality. ECB President Christine Lagarde said in a statement, "I am glad we were able to have in-depth discussions and we made good progress in shaping the concrete features of our future monetary policy strategy". The Euro STOXX index dropped 1.16% last week.

In Italy, Prime Minister Mario Draghi called for more stimulus to restore the pre-pandemic growth trend. He said in a statement, "Our objective must be to bring economic activity back to at least the trajectory it had before the pandemic. We will not reach this objective without additional effort. So we must act on it promptly and effectively". The Italian Central Bank sees the economy growing above 5% this year. Italian stocks declined 1.94% last week.

In the United Kingdom, Public Health England announced that a fourth lockdown might be needed this year to contain a surge in COVID-19 infections. Travel industry officials warned that195,000 jobs are at risk and advised against further restrictions. Under current rules, travelers from non-green-listed jurisdictions must quarantine upon arrival. The British aviation industry has been the hardest hit in Europe according to the British Airline Pilots Association. The FTSE 100 index declined 1.63% last week.

APAC

In China, policy makers organized a meeting with top banks and fintech companies to reinforce a ban on cryptocurrency services, including facilitating crypto-related transactions. Bitcoin sold off on the news, adding to the volatility seen in recent weeks. Meanwhile, the People's Bank of China is still conducting trials of the digital yuan in several cities and is planning a wider rollout at the Beijing Winter Olympics. The Shanghai Composite index dropped 1.8% last week.

In Japan, Bank of Japan (BOJ) decided to leave interest rates unchanged at the last meeting while extending its COVID-19 support program for small businesses. Consumer prices were down 0.10% year-over-year in May, as deflation continues to be the main concern for policy makers. BOJ Governor Haruhiko Kuroda joined Christine Lagarde on the climate change front and pledged to support environmental initiatives through monetary policy. The NIKKEI 225 gained 0.05% last week.

EMERGING MARKETS

In Brazil, the Central Bank lifted its benchmark interest rate last week by 75bps to 4.25% amid surging inflation expectations. Consumer prices have been rising at a rapid pace since the beginning of the year, leading to the third rate hike in three months. After a challenging first quarter, the Brazilian real strengthened since the beginning of the hiking cycle. The Brazil Ibovespa index dropped 0.80% last week, dragged by the sell-off in metals.

In India, stocks are trading near all-time high despite the economic impact of COVID-19. The Reserve Bank of India has warned against speculation bubbles building in the stock market as equities gained 53% in the last 12 months. The country is now battling cases of Mucormycosis, which is a rare fungal infection seen in most COVID-19 patients and has a high mortality rate. India has reported 28,000 cases of Mucormycosis so far. The Nifty 50 index declined 0.73% last week.

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