Level Four Capital Management

WEEKLY INSIGHT

HIGHLIGHTS

- U.S. equities finished near the lows of the week, snapping their three-week winning streak on Friday.
- Small-Mid Cap stocks continue to underperform the S&P 500, lagging by roughly 8% in July.
- CPI data released shows that year-over-year inflation crept higher than anticipated, coming in at 5.4% vs 4.9%. Despite the higher headline number, Fed chair Jerome Powell continued to reiterate the groups "transitory" stance.
- With easy monetary and fiscal policy, inflows into ETF's posted their best first half of the year ever, raking in $483B.
- Yields continued to tumble with the 10-year touching new five-month lows, closing below 1.20% for the first time since February.
- All 11 sectors closed lower led by value sectors such as Energy, Financials, Materials, and Industrials amid concerns over the resurgence of COVID-19 and the Delta variant.
- The rotation trade was exacerbated on Monday, July 19th, with re-opening names coming under pressure, while stay-at-home names outperformed. Travel-related names, including airlines, hotels, and cruise lines came under outsized pressure.
- In France, health care workers will be required to be vaccinated under a new regulation. The CAC 40 index slid 1.06% last week.
- In South Korea, policy makers are considering raising interest rates in the coming months. The KOSPI index gained 1.83% last week.
- In Chile, policy makers decided to lift the overnight rate last week by a quarter-point to 0.75%. The IPSA index declined 2.23% last week.

MARKET COMMENTARY

LAST WEEK

U.S. equities finished near the lows of the week, snapping their three-week winning streak as multiple market dynamics, including:

- Underperformance of Small/Mid-Caps: Russell 2K underperformed the S&P 500 by roughly 8% in July
- Lackluster volumes
- Retracement of yields below 1.30%% on the 10year
- Resurgence of the COVID-19 Delta variant
- Recent run up in equity markets
- Continued easy monetary and fiscal policy
- Inflationary pressure continuing to surprise to the upside

Source: Bloomberg as of 07.21.21

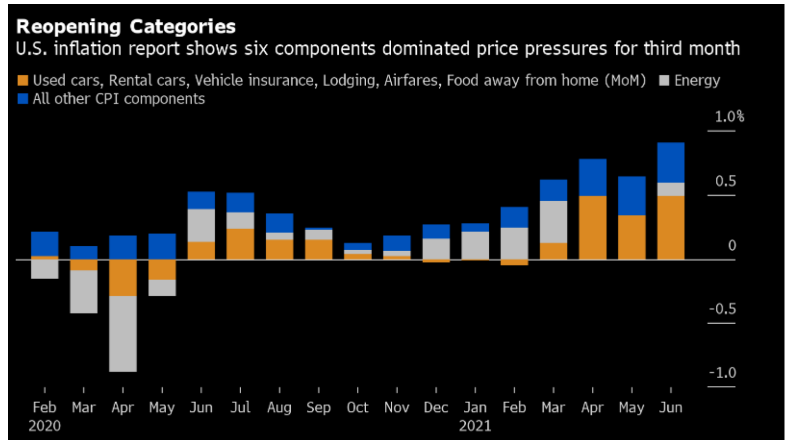
Each of these dynamics weighed on major averages. With current positioning and the aforementioned overhangs, the overall backdrop in the near term appears to be on fragile footing for U.S. equity markets. When all was said and done, the Russell 2K was the largest decliner, falling 5.11%, followed by the NASDAQ, S&P 500, and Dow Jones Industrial.

Concerns about the COVID-19 variant continued to dominate headlines with fears that some areas may pause the re-opening of their economies, which came after LA County said they would re-impose their indoor mask mandate. The move to do so by city officials followed health officials' statement noting that U.S. COVID-19 cases were up 70% on a weekly basis while deaths have jumped 26%. However, the numbers remain well below previous levels.

FEDERAL RESERVE COMMENTARY & INFLATIONARY PRESSURES

Concerns of inflationary pressures persisted throughout the week as Fed Chairman Jerome Powell did his best to ease investor concerns regarding inflation fears. CPI data released showed higher pressures to the upside, with the Consumer Price Index jumping 5.4% year-over-year, versus expectations, which called for a 4.9% increase. Mr. Powell continued to reiterate the Central Banks' stance to House and Senate committee members, saying prices are likely transitory.

However, even as the Chairman continued to stick to his story of "transitory" inflation pressures, Federal Reserve Bank of St Louis President, James Bullard, said that the group has met its goal of achieving "substantial further progress" and urged policy makers to reduce stimulus and end "emergency measures". The dichotomy between different members of the Central Bank only highlights those inflationary pressures that may or may not be here to stay permanently.



Source: Bureau of Labor Statistics, Bloomberg as of 07.21.21

COLOR FROM THE DESK

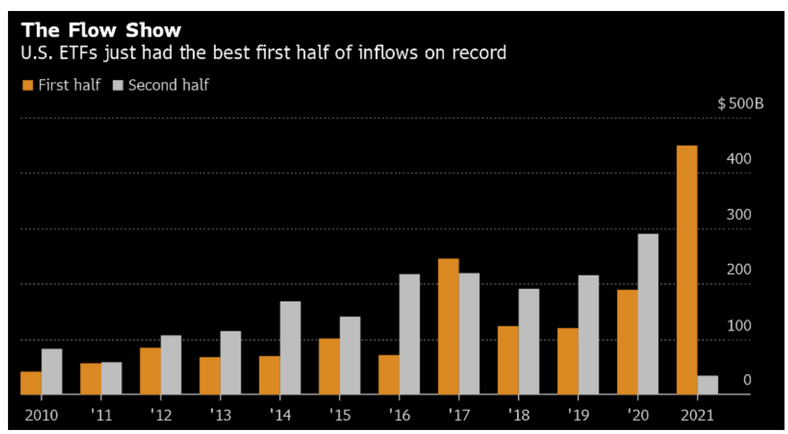
Commentary from one institutional trade desk illustrated the following for last week's price action:

- Remain heavily skewed to the buyside, driven largely by index managers
- Active managers have remained dollar neutral (selling and buying same notional amount)
- Long only managers have flipped to be better sellers
- Inflows have been into REIT's, Healthcare, and Tech with the latter two being in favor for the last few weeks now

ETF INFLOWS

With near record low interest rates, continued easy fiscal/ monetary policy, economic stimulus and significant market dislocations that seemingly trade on meme stocks/COVID-19 headlines, U.S. money managers with ETF products continue to see a huge inflow into the products.

Data recently released showed that ETFs just posted their best first half of inflows ever, and are on the cusp of attracting more money in the first seven months of 2021 than in any calendar year on record. Current inflows of $483B will likely break the $497B full year figure set in 2020.



Source: Bloomberg as of 07.21.21

THIS WEEK

It was an ugly day for investors as the Dow Jones Industrial registered its largest one day decline since late October, falling as much as 900 points mid-day before recovering slightly to close down 725 points (-2.09%). The losses come on renewed fears of COVID-19's spread throughout various parts of the world and its ability to derail the ongoing economic recovery.

The S&P 500 and NASDAQ Composite posted its largest one-day drop since May, falling 1.59% and 1.06% respectively. Small caps and the Russell 2K tracked broader markets, also declining more than 1.50%, which now brings its losses to more than 10% from its closing highs on March 15th. Looking to the rest of the week, earnings season continues to ramp up with multiple blue chip stocks releasing 2Q results. Even as investors will monitor and assess the earnings announcements, it would not be surprising to see stocks trade on COVID-19 headlines, given the fragile market feel.

YIELDS TUMBLE

The VIX index jumped about 22% to close at 22.50 as market participants express concerns over COVID-19 for the first time in months as stocks plunged.

Treasury prices jumped again with yields touching new five-month lows as the 10-year dropped more than 9bps (-7.61%) to 1.18%, its lowest levels since February. The decline comes as Coronavirus concerns weighed on the prospects for the global economy and drove investors toward various safe haven assets. The disconnect in fixed income markets continues to be exacerbated as yields move lower, but inflation data continues to move higher, seemingly illustrating that investors do believe the Fed's views of "transitory" inflationary pressures.

Source: Bloomberg as of 07.21.21

ROTATION RE-OPENING NAMES TO WORK FROM HOME

From a sector basis, all 11 sectors closed lower, led by various value sectors, which included Energy, Financials, Materials and Industrials. Financials dropped with lower yields, while Materials and Industrials were hurt by investor concerns over the potential pausing of global economies re-opening.

Ticker	Last Price	Net	%1D	%YTD	%5D	GICS SubInd Name
DAL US	↓38.56c	-1.50	-3.74%	-4.10%	-10.01%	Airlines
AAL US	18.97c	-0.82	-4.14%	+20.29%	-8.97%	Airlines
ALK US	↓52.83c	-1.79	-3.28%	+1.60%	-11.46%	Airlines
UAL US	43.46c	-2.55	-5.54%	+.49%	-14.14%	Airlines
CZR US	87.77c	-2.13	-2.37%	+18.18%	-10.76%	Casinos & Gaming
LVS US	47.34c	-0.48	-1.00%	-20.57%	-7.21%	Casinos & Gaming
MGM US	36.63c	-1.30	-3.43%	+16.25%	-11.80%	Casinos & Gaming
EXPE US	151.64c	-5.97	-3.79%	+14.53%	-9.39%	Hotels, Resorts & Cruise
CCL US	19.72c	-1.20	-5.74%	-8.96%	-17.35%	Hotels, Resorts & Cruise
NCLH US	21.87c	-1.27	-5.49%	-14.00%	-19.83%	Hotels, Resorts & Cruise
RCL US	69.51c	-2.88	-3.98%	-6.94%	-14.75%	Hotels, Resorts & Cruise

Source: Bloomberg as of 07.21.21

Travel-related names came under pressure with airlines falling anywhere from 3%-5%, and Cruise lines tumbling. Norwegian Cruise lines made new 2021 lows, while Carnival traded below $20 for the first time since February 3rd. Other re-opening sectors such as casinos and hotels also touched multi-month lows, while stay-at-home names such as Peloton, Etsy, Conagra, Kroger, and Wayfair all rallied with the rotation in full swing.

OIL PULLBACK

Oil was beaten up on Monday, falling 7% to close at $66.53 as OPEC+ announced they have come to an agreement that called for supply hikes of 400k bpd until the end of 2021, paired with concerns of waning demand, if global economies re-explored an economic shutdown.

INTERNATIONAL

Last week, global equities declined 0.69% as investors' angst rose because of the rapid spread of the Delta variant. Energy was the worst performing sector as Brent oil fell throughout the week and settled at $73.59 per barrel on Friday. Real estate continued to perform well as global rates fell. Utilities and consumer staples rallied as investors looked for safety in low volatility stocks. Question marks regarding the reopening of the economy and the sustainability of growth in a monetary policy-tightening environment led to a negative market sentiment.

EUROPE

The European Central Bank President, Christine Lagarde, warned that investors should expect a policy shift at the next meeting on July 22nd. She said that the bond-buying program should continue until March 2022 at the earliest. She added, "we need to be very flexible and not start creating the anticipation that the exit is in the next few weeks, months". The Euro STOXX index declined 0.80% last week, with travel and leisure down 4.69%.

In France, health care workers will be required to be vaccinated under a new regulation. For the broad population, a health pass will be required starting next month to access restaurants and other public venues. This pass will show that the holder has been fully vaccinated, has recently tested negative against COVID-19, or has fully recovered from the virus. Over 100,000 people protested last weekend across France against the new measures. The CAC 40 index slid 1.06% last week.

Bank of England's member, Michael Saunders, said it might soon become appropriate to phase out quantitative easing if growth and inflation "remain in line with recent trends". According to him, the Central Bank could begin to taper in the next two months. The British CPI rose to 2.5% in June, which is the highest level since August 2018. The bull market continues in the housing market as properties gained on average of $29,000 in value in the last six months according to Rightmove. The FTSE 100 index declined 1.6%.

APAC

In China, regulators cooled down the IPO market by empowering a new cybersecurity regulator to veto international IPOs. The measure will discourage smaller companies to list abroad because of the compliance burden. The biggest risk dampening investors' confidence remains the delisting from U.S. exchanges. In this instance, delisted ADRs could move to be traded on the United States' over-the-counter markets unless a broader ban is enforced. Last week, Chinese equities broadly recovered from the sustained selloff, before ceding to market fears on Friday. The Shanghai Composite index gained 0.43% last week.

In Japan, Softbank's vision fund plans to diversify away from China to offset the negative impact of the tech crackdown according to sources familiar with the matter. Bloomberg reports that Latin America could be the beneficiary of this strategy revamp, as close to $10 billion could be invested in the region. Softbank's vision funds have historically allocated more capital to the North America region compared to other regions. The funds have exposure to a couple of companies that delayed their IPO filling due to regulatory pressure. The NKY 225 index gained 0.22% last week.

EMERGING MARKETS

In South Korea, policy makers are considering raising interest rates in the coming months. The market is betting that Bank of Korea's monetary policy will remain accommodative longer than expected. In fact, daily COVID-19 infections surged to the highest level since the beginning of the pandemic. The vaccination campaign has been relatively slow as the government took a prudent approach to vaccine imports to have more data regarding side effects. According to Bloomberg, it will take eight months to have 75% of the population fully vaccinated. The KOSPI index gained 1.83% last week.

Last week in Chile, policy makers decided to lift the overnight rate by a quarter-point to 0.75%. The Central Bank plans to gradually tighten monetary policy amid a strong economic rebound. Central Bank of Chile projects that the economy will grow 9.5% this year and that the CPI will grow above 4%. The vaccination program success supports this forecast, with over 60% of the Chilean population fully vaccinated. Copper, which is the nation's preeminent natural resource, saw its price drop 12% from its peak in the last two months. The IPSA index declined 2.23% last week.

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