Level Four Capital Management

# WEEKLY INSIGHT

## Highlights

- All index's fell by at least 1.25% this week with the NASDAQ closed down 4%. The S&P registered its worst first half loss since 1970, down 19.76%.
- Treasury yields up to the ten pulled back below 2.9% with the 10-year coming back 25bps to close at 2.88%.
- Defensives sectors (HealthCare, Utilities, Consumer Staples) and Energy outperformed this year so far with Energy being the only positive sector.
- Bloomberg commodity index fell 2.5%, its lowest level since February.  Wheat and copper were down 30% from their year high.
- The Euro fell to a 20-year low versus the U.S. dollar at 1.02 per dollar as markets weigh recession risks.
- In Spain, consumer prices soared 10% year-over-year in June, up from 8.5% a month earlier. The Ibex index declined 0.85% last week.
- The Biden administration is exploring easing China tariffs to fight inflation. The Shanghai Composite index climbed 1.13% last week.

## Market Commentary

### U.S.

This week closed out the first half of the fiscal year and will be one that investors remember for years to come. The S&P registered its worst first half loss since 1970, falling 19.96% in the first six months of the year. As the second quarter wrapped up, major Index's finished the week broadly lower, with all broader benchmarks declining by at least 1.25%. The worst performer was the NASDAQ, which declined more than 4%, as growth names were particularly weak versus their value counterparts.

There were a number of bearish themes that remained intact, including:

- Consumer Sentiment (Bank of America noted that it's Bull & Bear indicator remains stuck at the zero "extreme bearish" levels for a third-straight week)
- Consensus that earnings estimates have remained too bullish
- The Fed continuing to tighten into a possible recession


| | Q1 | Q2 | Q3 | Q4 |
|---|---|---|---|---|
| 12 Yr Avg | 3.16 | 2.55 | 2.07 | 5.62 |
| 2022 | -4.95 | -16.45 | 1.22 | |
| 2021 | 5.77 | 8.17 | .23 | 10.65 |
| 2020 | -20.00 | 19.95 | 8.47 | 11.69 |
| 2019 | 13.07 | 3.79 | 1.19 | 8.53 |
| 2018 | -1.22 | 2.93 | 7.20 | -13.97 |
| 2017 | 5.53 | 2.57 | 3.96 | 6.12 |
| 2016 | .77 | 1.90 | 3.31 | 3.25 |
| 2015 | .44 | -.23 | -6.94 | 6.45 |
| 2014 | 1.30 | 4.69 | .62 | 4.39 |
| 2013 | 10.03 | 2.36 | 4.69 | 9.92 |
| 2012 | 12.00 | -3.29 | 5.76 | -1.01 |
| 2011 | 5.42 | -.39 | -14.33 | 11.15 |
| 2010 | 4.87 | -11.86 | 10.72 | 10.20 |

-20.00 … 19.95

*Source: Bloomberg as of 07.06.22*

In equity markets, defensive sectors and energy continue to outperform with Utilities, Health Care and Consumer Staples among the best performers on the week, all which finished in positive territory. FANMAG, travel & leisure, retail, and semi-conductors all came under outsized pressure and were among the worst performing names.

Yields across the curve sank, falling to their lowest levels since the end of May as recession fears mounted. A decline in yields can be a sign of investor concern, due to the inverse relationship between yield and price, with investors piling into safe haven assets, bidding up prices and pushing yields lower. While yields would generally move higher with inflation concerns, investors seem to be accepting of the Fed's plans to combat inflation, and instead have moved lower on future growth fears. The U.S. 10-year finished at 2.88%, down 25bps on the week.

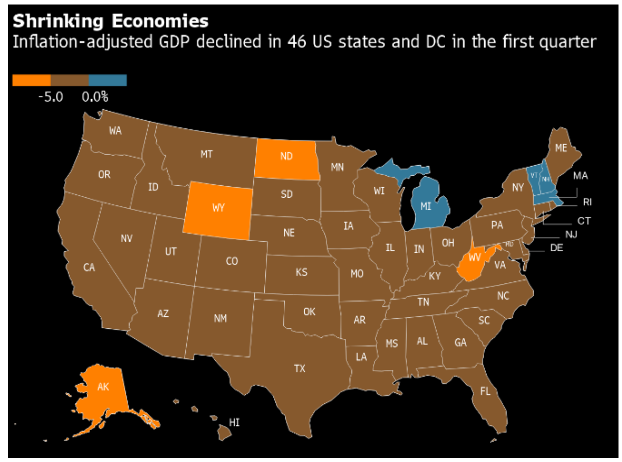
## BEAR MARKET AND RECESSION FEARS

As mentioned earlier, the S&P 500 closed down a tad shy of 20% on a year-to-date basis, which is essentially classified as a bear market (move 20% or more lower). Although a recession, defined by two consecutive periods of negative growth may be on the horizon, it is not guaranteed. Historically, since 1950, nearly 70% of bear markets coincide with recessions.

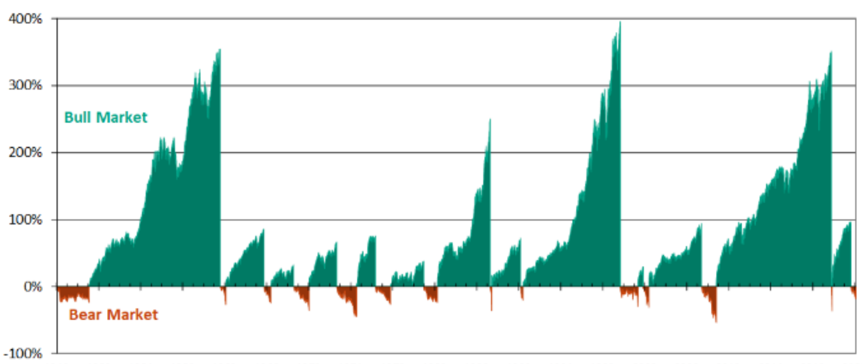
However, there are other factors that determine if a recession will occur and the severity of the recession.

While bear markets can make even the most sophisticated investors question themselves, we wanted to provide a few facts according to Hartford Funds about bear markets:

- Stocks lose on average 36% in a bear market. By contrast, they gain 114% during a bull market.
- There have been 26 bear markets in the S&P 500 since 1928. However, there have also been 27 bull markets, with stocks rising over the long-term.
- Bear markets tend to be short lived and on average last about 289 days, which is significantly shorter than the average length of a bull market of 991 days. It is worth noting the most recent 14 bear markets have averaged 359 days.
- Don't try to time the market. Half of the S&P 500's strongest days in the last 20 years occurred during a bear market. Another 34% of the market's best days took place in the first two months of the bull market.




*Source: Bureau of Economic Analysis, Bloomberg as of 07.06.22*




*Source: Bloomberg as of 07.06.22*

From a sector perspective, the more "recession proof" areas of the market have performed relatively well, with defensive sectors such as Utilities, Consumer Staples, and Health Care all outperforming. Energy (the outlier this year), remains the only sector that is higher in 2022, gaining 31.64%, but that has been driven more from the large supply and demand imbalances, rather than a risk-off, defensive positioning move.

## TIMING THE MARKET

It is LFCM's opinion that timing the market is nearly impossible. However, if the market is in fact at or near a bottom, the historical returns following present a great risk/reward ratio for long-term investors.

| Recession | Market trough | 12-Month Returns |
|---|---|---|
| Nov 48- Oct 49 | 6/13/1949 | 42.1% |
| Jul 53 - May 54 | 9/14/1953 | 37.7% |
| Aug 57 - Apr 58 | 10/22/1957 | 31.0% |
| Apr 60 - Feb 61 | 10/25/1960 | 30.7% |
| Dec 69 - Nov 70 | 5/26/1970 | 43.7% |
| Nov 73 - Mar 75 | 10/3/1974 | 38.0% |
| Jan 80 - Jul 80 | 3/27/1980 | 37.1% |
| Jul 81 - Nov 82 | 8/12/1982 | 58.3% |
| Jul 90 - Mar 91 | 10/11/1990 | 29.1% |
| Mar 01 - Nov 01 | 10/9/2002 | 33.7% |
| Jan 08 - Jun 09 | 3/9/2009 | 68.6% |
| Feb 20 - Apr 20 | 3/23/2020 | 74.8% |
| | | ***Average = 43.7%*** |

*Source: Bloomberg as of 06.23.22*

Past performance is no guarantee of future results. It is not possible to invest directly in an index.

## COMMODITY ROLLOVER & INFLATIONARY PRESSURES

While oil and a wide swath of other commodities have seen historic increases, investors have started to see the easing of some pricing pressures. The narrative goes hand-in-hand with the recent pickup in discussions regarding expectations that peak-inflation may be behind us.

| 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | YTD |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 13% TIPS | 19% Developed | 38% Small Cap | 30% REITS | 5% Growth | 18% Value | 31% Emerging | 0% Agg Bonds | 31% Value | 33% Growth | 40% REITS | 37% Commodities |
| 9% REITS | 19% Emerging | 35% Mid Cap | 14% Mid Cap | 2% REITS | 18% Small Cap | 27% Growth | -1% TIPS | 31% Growth | 21% Large Cap | 39% Commodities | -8% TIPS |
| 8% Agg Bonds | 18% REITS | 34% Growth | 13% Value | 2% Large Cap | 12% Emerging | 26% Developed | -1% Growth | 31% Mid Cap | 19% Small Cap | 31% Growth | -10% Agg Bonds |
| 2% Growth | 18% Small Cap | 32% Value | 13% Large Cap | 0% Agg Bonds | 12% Large Cap | 23% Large Cap | -3% Large Cap | 31% Large Cap | 18% Mid Cap | 28% Large Cap | -10% Value |
| 2% Large Cap | 17% Value | 32% Large Cap | 12% Growth | 0% Developed | 11% Mid Cap | 19% Mid Cap | -6% REITS | 29% REITS | 15% Emerging | 25% Value | -15% Emerging |
| 0% Value | 16% Mid Cap | 22% Developed | 8% Small Cap | -1% Mid Cap | 10% Commodities | 16% Small Cap | -9% Value | 27% Small Cap | 11% TIPS | 25% Mid Cap | -19% REITS |
| -2% Mid Cap | 16% Large Cap | 2% REITS | 6% Agg Bonds | -2% TIPS | 9% REITS | 15% Value | -9% Small Cap | 22% Developed | 10% Developed | 18% Small Cap | -19% Developed |
| -3% Commodities | 15% Growth | -2% Commodities | 3% TIPS | -4% Value | 7% Growth | 5% REITS | -9% Mid Cap | 20% Emerging | 7% Agg Bonds | 11% Developed | -20% Large Cap |
| -3% Small Cap | 7% TIPS | -2% Agg Bonds | 1% Emerging | -4% Small Cap | 5% TIPS | 4% Commodities | -14% Commodities | 16% Commodities | 2% Value | 6% TIPS | -21% Small Cap |
| -13% Developed | 4% Agg Bonds | -5% Emerging | -6% Developed | -15% Emerging | 3% Agg Bonds | 4% Agg Bonds | -14% Developed | 9% Agg Bonds | -5% REITS | 1% Emerging | -21% Mid Cap |
| -19% Emerging | -1% Commodities | -9% TIPS | -34% Commodities | -33% Commodities | 3% Developed | 3% TIPS | -15% Emerging | 8% TIPS | -24% Commodities | -2% Agg Bonds | -27% Growth |

| Grouping | |
|---|---|
| Large Cap | MGC-USA |
| Mid Cap | VO-USA |
| Small Cap | VB-USA |
| Growth | IUSG-USA |
| Value | IUSV-USA |
| Emerging | VWO-USA |
| Developed | VEA-USA |
| Agg Bonds | AGG-USA |
| TIPS | TIP-USA |
| REITS | VNQ-USA |
| Commodities | GSG-USA |

*Source: Bloomberg as of 07.06.22*

Focus continued to remain on slowing growth and tighter financial conditions, which may ultimately cause a shift in consumer spending and cause further deflationary pressures. Adding to the discussion of peak inflation was the Bloomberg commodity index, which fell by 2.5% this week, and now sits at its lowest levels since February.

Copper, which is a widely followed leading indicator, due to its wide array of uses, has experienced a 31% drop in price from its historic high of $4.94 a pound earlier this year and is currently trading at its lowest prices in the almost 18-months. Over the last three recessions (the early 2000's dot com bubble, the 2008 global financial crisis, and the 2020 COVID pandemic) investors have seen copper prices fall by at least 30%. However, we want to note that just because a 30% decline occurs, this does not indicate that a recession will follow.

Wheat prices have also fallen to their lowest levels in months, trading 35% off of its highs seen back in March, which is helping to slow food inflation. Wheat and corn (corn is also down over 20% in the last two months) can make up 50-70% of the cost of raising livestock, which to some degree is ultimately passed along to the consumer.

## FED HIKES

News surrounding the Fed this week was limited, although at a conference, Fed chair Powell said the biggest risk to the economy isn't that the Central Bank goes too far with policy tightening, but rather failing to restore price stability. According to the CME's FedWatch tool, expectations show a 65% chance of a 75bps hike in July, which is down from previous expectations of 95%.

# INTERNATIONAL

The Bloomberg World index declined 2.17% last week, with growth down 3.75% and value down 1.15%. The Bloomberg Commodity index slid 3.44% last week, as Brent oil fell 1.32%, and copper slid 3.97%. Markets are pricing in increased risks of recession amid global demand pullback in a context of monetary policy tightening. Global bond rallied 0.48% in a classic flight-to-safety trade. The report of a new COVID flareup in China was a negative catalyst for global stocks and investors' sentiment. A new wave of analyst downgrades hit already-battered stocks, making valuations more compelling.

## EUROPE

Joachim Nagel, Bundesbank President and European Central Bank (ECB) Governing Council member, warned that policy makers should be cautious on using crisis tools loosely and focus on fighting inflation. According to him, such tools should only be used under “exceptional circumstances and under narrowly defined conditions”. This comment came as the ECB pledged additional support last month to weaker nations via a special bond purchase program. This is the first major disagreement between Nagel and Christine Lagarde since the latter took office. The Euro fell to a 20-year low versus the U.S. dollar at 1.02 per dollar as markets weigh recession risks. The Euro STOXX index declined 2.15% last week, with real estate down 6.36% and information technology down 5.62%.

In Spain, consumer prices soared 10% year-over-year in June, up from 8.5% a month earlier. The Manufacturing PMI decreased from 53.8 in May to 52.6 in June amid declining sales. The Services PMI followed the same declining pattern, from 56.50 to 54.00 during the same period. The tourism sector continues to be affected by staffing shortage at airports and airlines. One of the ECB Governing Council members said in an interview that a 50bp hike should be an option at the next policy meeting. Christine Lagarde guided last week for a quarter-point rate hike instead to prepare markets for a gradual tightening cycle. The Ibex index declined 0.85% last week.

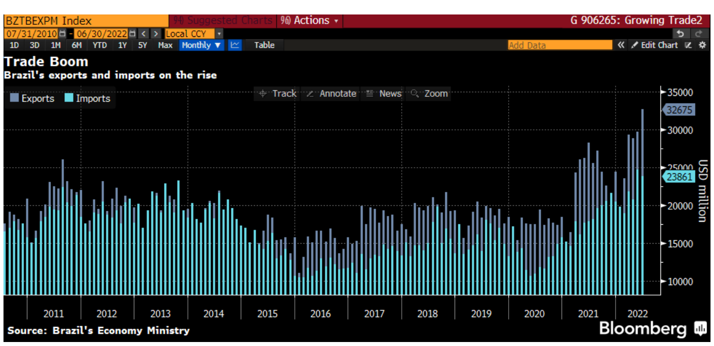

*Source: Bloomberg as of 07.06.22*

## APAC

In China, the reopening of the economy is threatened by a new Covid outbreak centered around the region of Yangtze Delta. Authorities are concerned by the new wave of infections and are starting to impose fresh restrictions on entertainment venues, with mandatory closure for seven days. Manufacturing PMI slightly increased in June from 49.60 to 50.20, but the new restrictions may slow down the recovery. Similarly, Services PMI jumped from 41.40 in May to 54.50 in June. The Biden administration is exploring easing China tariffs to fight inflation. The measure would apply to $300 billion worth of Chinese imported goods and directly impact the price paid by end consumers. The Shanghai Composite index climbed 1.13% last week.

In Japan, confidence among largest manufacturers fell to the lowest level since the peak of the Pandemic. The deceleration of Manufacturing PMI in June from 53.30 to 52.70 also points to a softening of the economy. Tokyo core CPI rose 2.1% last month, suggesting an acceleration at the national level. According to Bank of Japan (BOJ), the proportion of items showing a price increase is at the highest level since 2001. A growing number of hedge funds are betting that the BOJ will have to abandon its yield curve control policy and lift its 0.25% upper bound cap on benchmark bond yields. The yen remains close to a 24-year low against the U.S. dollar, at 135.67 per dollar. The NIKKEI 225 index declined 2.10% last week.

## EMERGING MARKETS




*Source: Brazil’s Economy Ministry, Bloomberg as of 07.06.22*

In Brazil, Economy Ministry raised exports forecast to $350 billion after record shipments. In June, exports grew 16% year-over-year to all-time high of $32.7 billion. Currency weakness may have contributed to the attractiveness of Brazilian goods and services. On Tuesday, the Real climbed to 5.38 per dollar, the highest level since the end of January. Manufacturing PMI edged down from 54.20 in May to 54.10 in June as soaring costs slightly offset the output improvement. Services PMI rose from 58.60 to 60.80 during the same period. Bolsonaro’s cash handout proposal keeps growing in Congress, as the bill’s latest price tag is $7.9 billion to include more beneficiaries. Brazilian stocks gained 0.29% last week.

In South Korea, inflation rose 6% year-over-year, the fastest pace since 1998. Bank of Korea will meet next week and is expected to deliver a 50bp hike. On Monday, Bank of Korea Governor Rhee Chang-yong and Finance Minister Choo Kyung-ho said they want to “act preemptively against rising economic risks”. The government announced a 5% raise to the minimum wage next year to help lower income households deal with higher prices. Kyunh-ho warned that wage increases could cause inflation and asked top executives to avoid raising pay competitively. The South Korea Manufacturing PMI declined from 51.80 in May to 51.30 in June. The KOSPI index declined 2.59% last week, with services down 4.72%.

## 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.

*Asset management services offered through Level Four Capital Management, LLC, an SEC-registered investment adviser.*