Level Four Capital Management

WEEKLY INSIGHT

Highlights

- US equity markets finished mostly higher, The Nasdaq was the best performer, gaining over 2% while the Dow Jones lagged, closing in the red by 0.13%.
- Risk assets such as Tech, Consumer Discretionary and Communication services were amongst the best performers on the week with all gaining more than 1%.
- Investors continued to see short covering in some of the most shorted names across the Russell 3K. The GS 50 most shorted index, has risen almost 16% over the last 2-weeks outpacing the S&P 500 by more than 11%.
- Jobs data showed that non-farm payrolls surpassed expectations, adding 528K vs estimates of 250K. This led to several members of the Federal Reserve to reiterate their aggressive monetary policy stance
- The unemployment rate registered its lowest reading since 1969 on Wednesday at 3.4%
- 87% of S&P 500 constituents have reported, the blended earnings growth rate now standing at 6.7%, versus expectations of 4.0%
- The Bank of England announced a half-point rate hike, which was in-line with expectations
- In Brazil, the unemployment rate dropped to 9.3% ahead of general elections, the lowest level in seven years

Market Commentary

U.S.

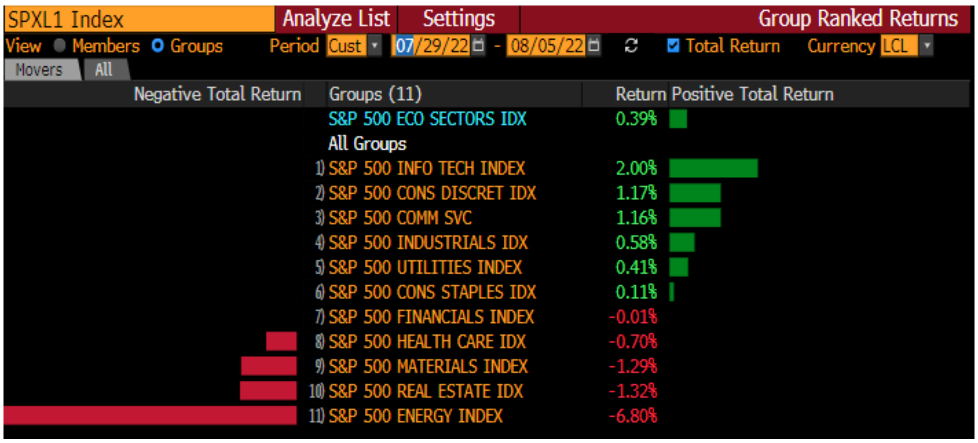
US equity markets finished mostly higher, despite the S&P 500 logging declines in 4 of the last 5 sessions. The Nasdaq was the best performer, gaining over 2% on the week, while the Dow Jones lagged, closing in the red by 0.13%. A large reason for the Russell 2K's rally has been attributed to the resurgence of Meme stocks and the Nasdaq's positive performance has been attributed to short covering. The Goldman Sachs most shorted index, which is comprised of the 50 most shorted names in the Russell 3K, has jumped 15.73% over the last 2 weeks versus the S&P 500 and Dow Jones which have gained 4.56% & 2.94% respectively.

Source: Bloomberg as of 08.10.22

Headlines, earnings, economic data and Fed speak all contributed to the busy week, which generally leaned more positive, as the path of least resistance remained to the upside. The most notable headline was the release of non-farm payrolls, which came in much stronger than anticipated, as well as the unemployment rate which registered its lowest reading since 1969. The general thought is that "good news is bad news," meaning that the better data/earnings are, the more likely the Fed will have to stay aggressive in their fight against inflation, raising rates more violently, and running the risk of tipping the US into a deeper correction/ recession.

Treasuries were weaker with the curve flattening as the 10-year treasury dropped to as low as 2.50%, however, they jumped again to finish the week at 2.84%. The move lower on the 10-year yield drove the 2's/10's inversion to its most negative levels since 2000 on Thursday.

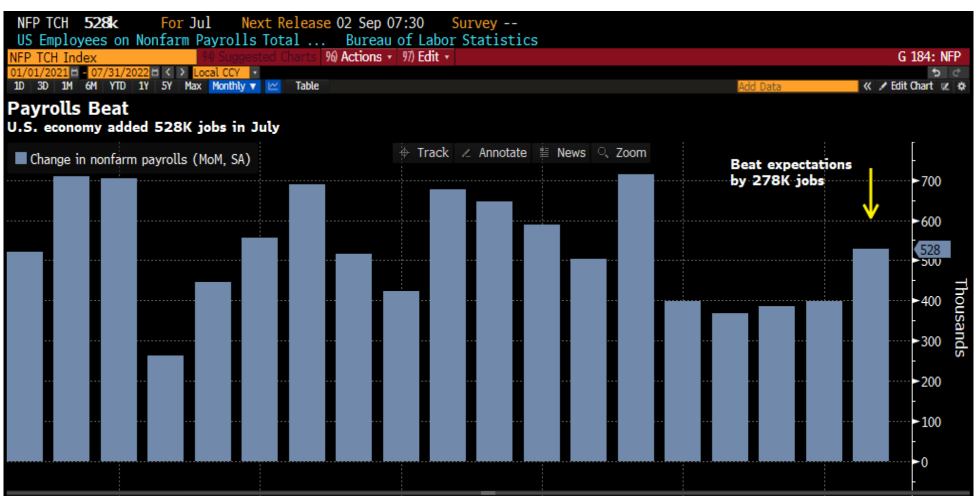
Risk assets such as Tech, Consumer Discretionary and Communication services were among the best performers on the week with all gaining more than 1%. Semiconductors, cloud software and hardware names were outperformers in Tech, while Consumer Discretionary was buoyed by AMZN and retail names. Energy was the worst performing with exploration and production companies, refiners and oil service names all coming under pressure on the week.



Source: Bloomberg as of 08.10.22

NON-FARM PAYROLLS AND THE LABOR MARKET

The biggest news on the week was the release of non-farm payrolls on Friday, which showed a gain of 528K jobs for July, crushing analyst expectations, which called for a gain of 250K.



Source: Bloomberg as of 08.10.22

Strength in the labor market has been one of the key factors that has led many in the market to believe the US is not in fact in a recession, outside of the technical definition. In fact, economists who work under the National Bureau of Economic Research actually determine whether or not a slowdown in economic activity can be classified as a recession and is usually done so on a retroactive basis.

With that in mind, data has shown that never before has the US registered its lowest unemployment levels during a recession, which would contradict the theory that a recession is already underway, since the unemployment rate ticked to its lowest levels in more than 50 years.

Generally, unemployment in the US reaches its lowest point (on a percentage basis) on average 7.5-months before a recession begins.

US Bureau of Labor Statistics economists have determined that a relationship exists between low unemployment levels, and the length, frequency and severity of the resulting recession. Simply put, current low unemployment would suggest a milder and shallow recession versus the deeper recessions experienced
over the last 50 years.

Unemployment Bottom	Unemployment Bottom	Months until Recession	Recession Starts
2.50%	May-53	2 Months	July-53
3.70%	March-57	5 Months	August-57
4.80%	February-60	2 Months	April-60
3.40%	September-68	15 Months	December-69
4.60%	October-73	1 Months	November-73
5.60%	May-79	8 Months	January-80
7.20%	December-80	7 Months	July-81
5.00%	March-89	16 Months	July-90
3.80%	April-00	11 Months	March-01
4.40%	October-06	14 Months	December-07
3.50%	February-20	1 Months	March-20
4.40%		**7.5 Months**	

Source: U.S. Bureau of Labor Statistics as of 08.10.22

FEDSPEAK

With the strong economic data, this has led many to predict the Federal Reserve will have to continue with their aggressive monetary policy stance, even as economic activity slows. Swap markets are now showing that a 75bp hike in September is more likely than a 50bp hike, which pushes back on the notion that the central bank has pivoted to a more dovish stance.

Additionally, several members of the Federal Reserve, during public appearances, used their time this week to throw cold water on that exact notion, including:

Show Models » Enable Overrides

Region: United States » Instrument: Fed Funds Futures »

Target Rate 2.50 Pricing Date 08/08/2022

Effective Rate 2.33 Cur. Imp. O/N Rate 2.344

Meeting	#Hikes/Cuts	%Hike/Cut	Imp. Rate Δ	Implied Rate	A.R.M.
09/21/2022	+2.743	+274.3%	+0.686	3.029	0.250
11/02/2022	+4.084	+134.1%	+1.021	3.365	0.250
12/14/2022	+4.795	+71.1%	+1.199	3.543	0.250
02/01/2023	+5.031	+23.6%	+1.258	3.602	0.250
03/22/2023	+5.085	+5.4%	+1.271	3.615	0.250
05/03/2023	+4.875	-21.0%	+1.219	3.562	0.250
06/14/2023	+4.459	-41.6%	+1.115	3.458	0.250
07/26/2023	+4.085	-37.4%	+1.021	3.365	0.250
09/20/2023	+3.640	-44.5%	+0.910	3.254	0.250
11/01/2023	+3.221	-41.9%	+0.805	3.149	0.250
12/13/2023	+2.837	-38.4%	+0.709	3.053	0.250
01/31/2024	+2.565	-27.2%	+0.641	2.985	0.250

Source: Bloomberg as of 08.10.22

- San Francisco's Mary Daly stated the Fed's fight against inflation was "nowhere near almost done, and that her and her staff are committed to bringing inflation down
- Cleveland's Loretta Mester said she is still waiting on compelling evidence that inflation is moderating and that she sees policy rates as high as 4%
- Minneapolis's Neel Kashkari argued the market is getting ahead of itself and that it is very unlikely that they (The Fed) will be cutting rates next year despite market expectations to the contrary.

While many continue to predict what the rate/ magnitude of future hikes will look like, one thing continues to be clear, the central bank will continue to fight inflation, making that their most important mandate (despite having a dual mandate of controlling inflation and managing the labor market), even if that means creating a stagflation environment.

EARNINGS

With 87% of S&P 500 constituents having reported, the blended earnings growth rate now stands at 6.7%, which is better than the 4.0% expected at the end of the quarter. While fewer companies are reporting bottom line beats versus the longer-term averages, and the magnitude of those beats have been smaller than average, top line revenue beats have fared better. Only 23 S&P 500 constituents are expected to report this week as Q2 earnings season winds down, with the market consensus being overall earnings were "better than feared".

OPEC+ DECISION

WTI crude declined almost 10% on the week, and finished below $90/barrel as concerns around weaker demand rose with heightened geopolitical uncertainties (the relationship between China and the US continued to be strained). Adding pressure on oil was OPEC+'s decision to increase output by 100Kbpd in September, which was widely anticipated. Ministers from the 13-member group and its allies, met on Thursday and agreed to the miniscule boost, which has been described as an insult directed at US President, Joe Biden who recently met with Saudi Arabian leaders to discuss increasing supplies.

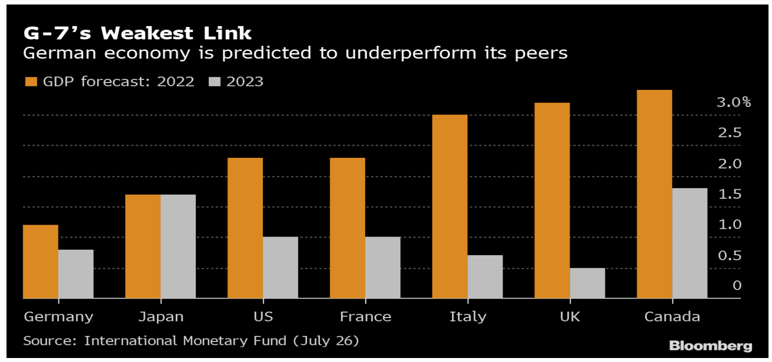
The boost comes as some members of OPEC+ have exhausted their output potential, adding that ""chronic underinvestment in the oil sector has reduced excess capacities". In June, the group under produced their quotas by about 3mbpd, as only Saudi Arabia and the UAE are believed to have spare capacity.

INTERNATIONAL

The Bloomberg World Index gained 0.37% last week, with growth up 1.03% and value down 0.62%. Brent crude oil futures declined 13.72% last week amid downward growth revisions and reduced inflation expectations. This move took Brent price to $94 per barrel, a level not seen since February, right before Russian invasion of Ukraine. The commodity index dropped 3.26% last week as the ongoing real estate crisis in China is altering demand expectations for commodities. The JPMorgan Global Manufacturing PMI ticked down in July to 51.10 from 52.20 a month earlier.

EUROPE

Euro-zone inflation jumped 8.9% year-over-year in July, compared to 8.6% a month earlier due to rising costs of food and energy. In Germany, consumer prices rose 8.5% despite temporary fuel-tax rebates and subsidized public-transport tickets. German Finance Minister said the government should not provide direct additional support to households, even though some members of the ruling coalition are recommending more stimulus. The government may instead focus on broader measures to secure energy supply. For instance, Germany recently agreed to inject $17.3 billion in the struggling utility provider Uniper SE to prevent the collapse of its energy network. The DAX index gained 0.67% last week.



Source: S&P Global as of 08.10.22

In the United Kingdom, Bank of England announced a half-point rate hike, in line with expectations. Governor Andrew Bailey told reporters that the committee will continue to monitor if inflation persists and will adjust policy accordingly. Bank of England now sees consumer prices peaking in October at 13.3% due to the surge in gas prices. In other news, the race to be the next Conservative Party leader and United Kingdom prime minister narrowed down to Ex-Chancellor Rishi Sunak and Foreign Secretary Liz Truss. Recent poll results suggest Truss leads the race, with her tax break proposal capturing broad media coverage. The FTSE 100 index gained 0.22% last week.

APAC

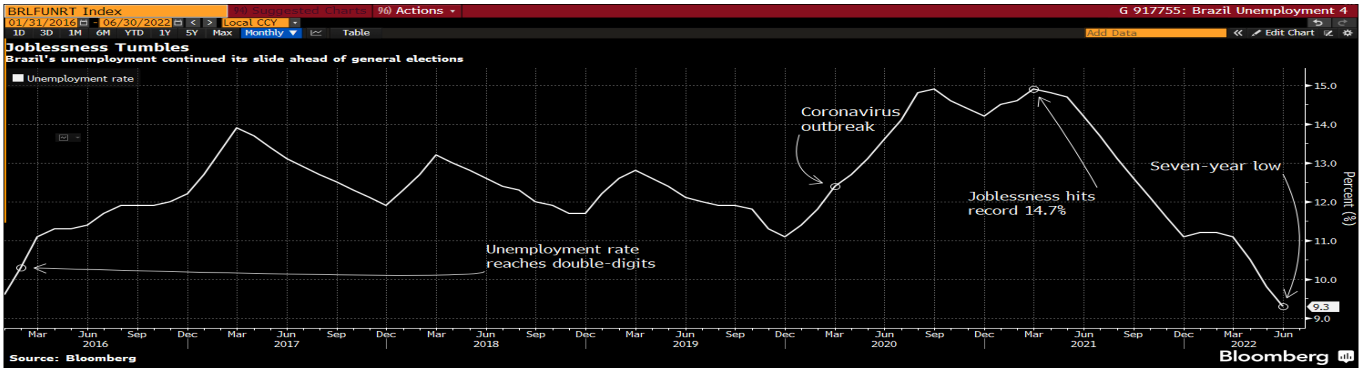
In China, the Eastern Theater Commander is conducting military drill near Taiwan's airspace in response to Nancy Pelosi's diplomatic visit. Over 120 aircraft crossed the median line in the Taiwan Strait last week according to the Taiwanese Defense Ministry. Domestically, China high-yield dollar bond average prices hit record low amid payment failures in the property market. According to data compiled by Bloomberg, offshore bond delinquencies have already exceeded $28 billion from January through July, versus $14 billion in 2021. China's top leadership did not indicate that a big stimulus plan is on the table to rescue the property sector and avoid contagion. The IMF slashed its China 2022 growth forecast from 4.4% to 3.3%. The Shanghai Composite index dropped 0.81% last week.

In Japan, nationwide inflation ex fresh food accelerated 2.2% year-over-year in June according to Japan's ministry of internal affairs. Economists raised their CPI outlook for the year and now see inflation rising above 3% by year-end. A departing Bank of Japan official said Japan needs a bolder monetary and fiscal stimulus to "seize once-in-a-lifetime opportunity to end deflation". The yen has rallied since hitting 24-year low due to short covering and reduced inflation expectations. US-Japan 10-year yield gap narrowed to 2.65% last week, after peaking at 3.22% in June. The NIKKEI 225 index gained 1.35% last week.

EMERGING MARKETS

In Brazil, economy minister Paulo Guedes discussed the country's outlook in a Bloomberg interview. He expressed his worries about global economy due to inflation, rising commodity prices and the fact that "central banks of advanced economies are way behind the curve" in his opinion. He added that Brazil is out of sync with the global economy as it has its own internal growth dynamic. The government revised its 2022 GDP growth forecast from -1.5% to 2% as the economy is expected to recover faster than anticipated. Unemployment rate dropped to 9.3% ahead of general elections, the lowest level in seven years. The Brazilian real further strengthened last week, solidifying its spot as the best performing Latin American currency year-to-date. Brazilian stocks gained 3.21% last week.

In India, Reserve Bank of India (RBI) raised its benchmark interest rates by 50bps to 5.4%, the highest level since August 2019. Following this update, the cumulative interest rate hike is 140bps year-to-date. RBI Governor Das said in the press conference following the policy announcement "Inflationary pressures are broad based and core inflation remains elevated. It's now basically a whatever-it-takes approach." The hawkish commentary helped the Indian rupee firm up as growth prospect remains attractive compared to peers. The RBI said it has used its foreign exchange reserves to defend the rupee and has sufficient stockpile to continue to do so if needed. Growth and inflation forecasts of 7.2% and 6.7% respectively were maintained. The Nifty 50 index gained 1.39% last week.



Source: Bloomberg as of 08.10.22

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