NAHMANI GRUNDER
WEALTH MANAGEMENT & MULTI-FAMILY OFFICE

Market Update

4th of June 2020

Dear Investor,

Markets have made history, and the S&P 500 closed above 3,100 levels yesterday (+39.6% from the lows in March). The corona outbreak and the ensuing panicked actions by governments due to a lack of data created an historic decline into a bear market (-34.0% in 4.5 weeks), followed by a very swift recovery from the 23rd of March onwards. **This will go into history books as the shortest-ever bear market**. In addition, the S&P 500 is now only down -3.3% for the year-to-date 2020 period, while MSCI World has also recovered to be down -5.8%.

The **first phase of the market recovery starting on March the 24th was marked by the complete leadership of the Tech and Health care sectors**. The market correctly concluded that these structural growth companies with recurring revenues would come out of the covid-19 crisis with negligible negative impact, with some even benefiting from it. This initial rally concentrated on a few sectors was **also a clear reflection of the impact of swift and large FED policy support in completely eradicating tail risks of financial systemic implosion for investors**. Thus, in our view, the market at that stage was very rationally not taking any view on the slope of the economic recovery post the exit from the lockdown measures. It was merely separating the winners from the losers even under the scenario of a protracted downturn. The market was simply pricing in the fact that some companies and sectors would come out of the crisis with little damage even if the economy took years to regain its previous footing.

As a result, this pushed the Nasdaq-100 (NDX) and the US Software ETF IGV into positive territory for the year-to-date 2020 period already by mid-April 2020. Having managed this first phase very well, we concluded in May when the S&P 500 reached 2,900 levels that, the first phase of this market recovery had now been completed, and that we were now due for a consolidation phase with a possible shallow drawdown. Our original thesis was that this consolidation phase would then set us up for a second phase of market recovery, which would then take us to 3,300 – 3,600 levels on the S&P 500 by mid-2021 (P/E 2021 of 22x at that time). This was under our base case scenario calling for S&P EPS to be flat-to-down 10% in 2021 versus 2019.

Since last week starting from 22 May, equity markets have now started to more decisively move into this second phase of the market recovery by taking a more aggressive stance on pricing in growth expectations from here. Thus, our expected consolidation phase never really took hold with this immediate extension directly into this second phase. This move has naturally created a leadership change in equities towards the more growth sensitive cyclical sectors, such as Financial Services. The worst-3 sectors in MSCI World for the year-to-date period until 22 May 2020 included all the growth sensitive cyclical sectors: Energy -37%, Financial Services -31% and Industrials -21%. Interestingly, since the 22nd of May, these same 3 sectors have been the best-3 performing sectors in MSCI World, with Financial Services +16%, Industrials +11% and Energy +8%. Since the 22nd of May, Tech and Health care are still up for that period, but clearly not keeping up with these 3 previously laggard, growth sensitive sectors.

Is this move of the S&P 500 from 2,900 to 3,100 premature? Clearly, many economies around the world have started to exit from the government mandated lockdowns since late-April/early-May, and the global economy is slowly healing from the strict "time-out" enforced by governments. We are experiencing inflection points in high-frequency datapoints and growth momentum indicators. April will likely mark the nadir/trough of global and US economic growth, with the second derivative (the rate of change in the underlying growth) turning positive as of May. For example, VISA reported last night that total US switched volumes through its payment network declined by "only" -5% year-on-year (YoY) in the month of May 2020, versus a decline of -18% YoY in April. In Spain, total daily new car registrations reached 4,000 by mid-May, versus 0 during April and 7,000 daily on average, pre-covid 19 in January/February 2020. Adidas stated this morning that overall revenue growth in Greater China turned positive for the month of May, after all it's owned and partner-operated stores in the region opened in mid-April. With major inflection in growth momentum indicators around the world, we understand the instinctive reasons for markets to be more willing to take a bet on the slope of the recovery from here. US 10-year breakeven, as an indicator of mid-term inflation expectations in the US, have also risen to 1.20% today, from 0.55% at the lows in March and 0.95% in mid-April. However, our opinion remains unchanged that it is too early to bet decisively on firm growth projections given the ensuing uncertainties, and we continue to be assert that the S&P 500 above 2,900 is a bit of a stretch at this time.

The first phase of the market recovery taking the S&P 500 from 2,237 to 2,900 was clearly justified on global central banks' policy action and, most importantly, the FED put option, The FED balance sheet has risen from $ 4.16 trillion at the end of February 2020 to $ 7.1 trillion by 27 May 2020 (35% of US GDP). **The surge from 2,900 to 3,100 since 19 May clearly takes us into unchartered waters where the margin of error on growth expectations are slim**. **Accordingly, our current playbook is clearly not to chase the current cyclical rally in equity markets, while keeping our current overall net equity and sector exposures intact**. Our bottom-up playbook to approach the second phase is in place, with a handful of cyclical stocks already held and others still to pick from when the timing is ripe such as US Banks and the Global Oil E&P sector.

Having said this, we want to point out that Brent Crude Oil prices (International, sea-borne Oil benchmark price) has recovered from $ 18-20 per barrel levels in mid-April to currently $ 38 – 39 per barrel. **The shares of diversified, conventional Oil exploration & production (E&P) companies, such as Royal Dutch Shell, have clearly lagged this underlying Oil price recovery which we believe is sustainable**. And, at current prices, **if one has the need to bulk on some cyclical stocks, we would clearly prefer some of the Oil E&P stocks**, rather the Financial Services sector, especially in a European context. With Brent Oil prices back to $ 40 per barrel, we believe Shell should be in a position to reinstate its original annual dividend policy of $ 1.78 per share, which would then put the dividend yield above 10% at the current share price.

Brent Crude Oil price development

All the best,

The Nahmani Grunder Investment Team