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February 29th, 2020

In this strategy briefing…

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Short-term technical indicators are at extreme levels, which have historically supported a rebound. However, there is no meaningful evidence to state a long-term bottom is developing. The Standard & Poor's 500 index slicing through theoretical support at its 50- and 200-day moving averages is a case in point. – Technical – Page 9

After setbacks in the first three primaries, former Vice President Joe Biden is set for a must-win decision by the Democratic voters in South Carolina vote Saturday. He has counted on a deep reservoir of goodwill among African-American voters to save his candidacy in a state where 60% of the Democratic primary voters are black. Nevada. – Policy – Page 11

FS Insight Investment Views

Near Term View:	"V-shaped bounce expected", PMIs recovering, Inventory cycle bottoming, 2020: "E" matters more than "P/E"
'20 Target:	3,450 (YE P/E 17.9x · 2021 EPS $193)
Style:	Cyclical + Value
Granny shots:	GOOG, AAPL, AMP, PYPL, NVDA, CSCO, XLNX, FB, MNST, VRSN, DE, QCOM, KSU, EXPE, MXIM, MSFT, TTWO, ROK, DOV, PSX, BKNG, EBAY, EMR, TSLA, AXP, BF/B, PM, GRMN
Additions:	None
Deletions:	None

The Wall Street Debrief

Vito J. Racanelli
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Formerly a Senior Writer at Barron's, where he covered stocks, bonds, and financial markets

@WSintelligencer

Some $4 Trln in World Market Cap Disappears in Equity Rout

Well that was painful. Last week, I wondered aloud if the market might look through the coronavirus outbreak. Wrong. The stock market "corrected" last week and deeply, a polite way of saying everyone began to jump ship, and all at the same time.

Indeed, at the Standard & Poor's (SPX) close of 2954 the market is three-fourths of the way to a bear market, that is, a 20% or more drop from the high. The other major indexes have fallen similarly. While I've been watching markets for decades and have lived through three deep bear markets, I'm amazed at the rapidity of this decline, which includes seven consecutive down days. According to Bespoke Investment Group, this past week's 11.3% is among the worst weekly drops in history going back to 1927. The SPX is 12.8% from the Feb. 19 high.

Poof. There went roughly $3.5 trillion worth of U.S. market cap, with more losses elsewhere. Indeed, the whole world slumped, with MSCI World Index ex-US down about 12% from the most recent highs hit in January. It was sell first and ask questions later, in active trading.

The ostensible reason is the spread of the coronavirus, or COVID-19, as it's known scientifically. In particular, the previous weekend saw the confirmed cases across continents from Asia and that really spooked investors. It's getting close to home. The U.S. has about 62 confirmed cases. As of Friday, according to the John Hopkins Center for Systems and Science Engineering, there were about 84,000 confirmed cases of COVID-19 and less than 3,000 deaths, the overwhelming majority of both in China. And I'll concede that it is a reasonable thing to doubt the numbers coming out of China.

As scary as the outbreak is for both the media and investors—I remain unconvinced this is a wholesale pandemic—there are probably additional underlying reasons for the big drop. For one, the market had gone a long way very quickly and as our very own technical analyst, Robert Sluymer, has been saying, it looked overbought and due for a mid-February drop. For more see page 9.

Second, and more realistically, investors are worried that a continued spread of COVID-19, even a minimal one, means that global economic growth will slow down. That's not unreasonable, though I think that longer term that won't be a problem if the virus, as I expect, will be contained. Factories and stores will reopen, supply and factories restart, and growth will return.

There's also market chatter a Federal Reserve emergency rate cut coming soon, either at the scheduled March 17-18 meeting or sooner, if the markets keep puking, or even of some kind of global coordinated central bank action this weekend. That might put a temporary floor on the declines. Ultimately, market will have to be convinced the virus is not going to explode in cases. The bond market soared with yields finishing near all-time records, as investors fled to what is perceived as safe havens. Of course, if this unwinds quickly they won't have been very safe. See page 6 for more on this.

The so-called fear index, or VIX futures, action is instructive. The VIX jumped to 49 from the low teens a few weeks ago. As my colleague Tom Lee notes later in this note, the forward months of the VIX futures show lower expected levels. In other words, the market is pricing in near term event risk (backwardation). This level of backwardation is severe, indicating markets see sharply higher risk of "event risk" in the near term. This, in our view, is often a sign of a market nearing a bottom. See page 3.

We all know the market is a discounting machine and that right now it is pricing in a pandemic, but I don't think you have to be all knowing or a medical doctor to see the market is shooting first and asking medical questions later.

Earlier this week, in a conference call Advisors Capital Management folks mused the following: the market's decline and the trillions of dollars of market cap lost mean investors believe there will be a permanent 15% or so decline in value of that level to the stock market as a result of the virus.

For that drop in value to be justified this one virus is going to cause a 15% permanent decline in profits for every SPX company or on average it is a 15% permanent decline. I don't think so but likely the market won't be convinced otherwise until it sees the outbreak peak in the major countries. Governments and institutions around the world are working to stem the virus. I think they will be successful and sooner rather than later. Already, it appears to be peaking in China.

Questions? Contact Vito J. Racanelli at vito.racanelli@fsinsight.com or 212 293 7137. Or go to www.fsinsight.com.

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@Fundstrat

Markets Smell Fear But 60% Probability of 'V'-Shaped Bounce

The trading action in recent days certainly shows that the smell of fear is in the air. The bears won last week's battle, even as they've been losing the war for years.

The Standard & Poor's 500 index had one of its worst few consecutive days ever, declining a stunning 12.8% in seven days. Such decline velocity was last seen in 2008. Cue the panic. The mounting hysteria around COVID-19, and a growing consensus that "nothing is safe" is only amplifying the view that equities will not find a floor until the world is past "peak Corona virus" spread.

The fog of losses is obscuring investor vision, but I think that in the past month, and particularly in the past week, significant divergences between asset markets suggest that the SPX might see a catch-up trade that leads to a "V-shaped bounce." This is consistent with our commentary earlier this week that I believe there is a 60%-plus probability stocks are bottoming about now.

Source: FS Insight, Bloomberg

First, consider the stock market in China—the epicenter of coronavirus—bottomed three weeks ago (after falling 14%) and then had V-shaped 14% rally to within 2% of three-month highs. Think about this. China's infections are still growing, with the economy at a virtual standstill, yet the equity market has staged a V-shaped rally.

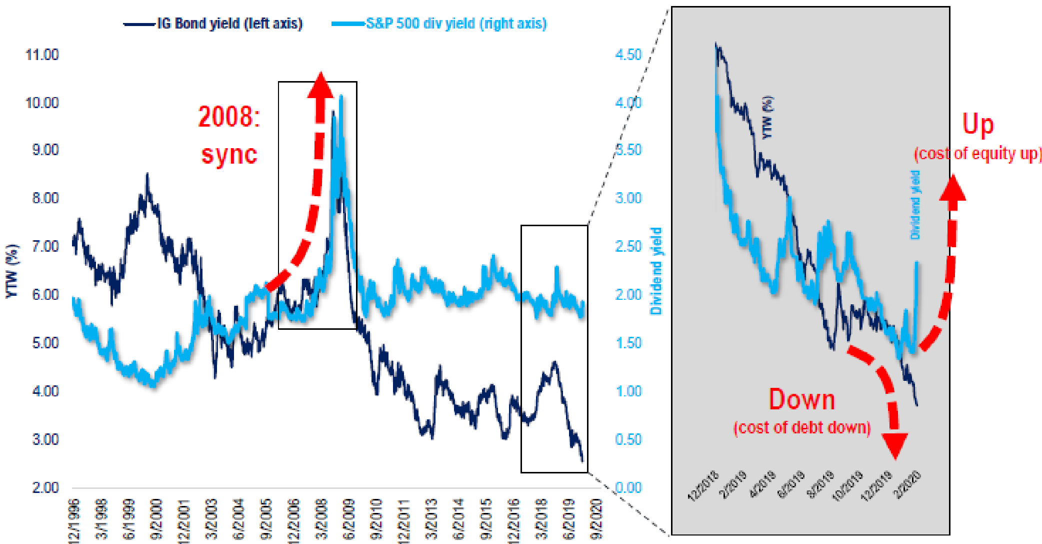
Second, if a vast deterioration of US corporate fundamentals is being "priced in" by the equity markets, why have investment grade (IG) bond yields plunged to a 25-year low to 2.54% (2.97% on 12/31/2019)?

Contrast that to the 2007-2008 financial crisis, when IG yields rose from 5.5% to 6.28% (yearend 2007) on their way to 10%, which is what you'd expect if markets were worried about corporate fundamentals. Today, in 2020, we see a complete divergence between IG funding costs and the cost of equity, while in 2008, both rose in sync. (See chart below.)

Moreover, the spread between the SPX dividend yield of 1.93% and the IG yield of 2.54% is the narrowest in 25 years. This is a pretty unusual divergence, and in my view further supports why stocks could stage a V-shaped bounce. The average spread is 3.41%, meaning if dividend yield is 1.93%, IG yields should be 5.34% (not 2.54%). This is the narrowest ever spread, meaning stocks haven't been this cheap since 1996. Think about that. The issuer is the same, so why should the funding cost of the bond be that much lower than the equity? By the way, these spreads were very narrow in Nov. 2012 and July 2016, two times that turned out to be very good entry points for equities.

Third, there have been 10 times since 1948 when stocks fell for 6 consecutive days and saw cumulative declines greater than 8%. Ten out of ten times, stocks were higher 12 months later, with a median gain of 28.5%. Now the past isn't always prologue, but more importantly, when the Purchasing Managers Index was greater than 50 at the time of the slides, stocks were higher 100% of the time 3, 6 and 12 months later.

Figure: ICE BofAML US Corporate 7-10 Year Semi-Annual Yield to Worst, Percent and S&P 500 Dividend Yield
Since 1996



Source: FS Insight, Bloomberg

Let me also point out that the so-called fear index, the VIX, touched 48 Friday morning, a level seen only at major turning points in 2010, 2011, 2015 and 2018. This is pretty indicative to me. Additionally, the forward months of the VIX futures show lower expected levels. In other words, the market is pricing in near-term event risk (hence, in backwardation). This level of backwardation is severe and shows markets see sharply higher risk of "event risk" in the near term. This, in our view, is often a sign of a market nearing a bottom.

Notably, despite the elevating fears of Corona COVID 19, the long-term U.S. Treasury bond yield curve is steepening. We have written about this extensively in the past and have shown the 30-yr-10-yr curve is quite sensitive to macro-economic shocks and changes. But rather than flattening, it has been slightly steepening. This isn't what you'd expect ahead of economic troubles.

What could go wrong? Could a recession or bear market be starting? Price is signal and there is certainly a foreboding message in the plunge in stocks. There is simply fear about the ability of governments to stop the spread of corona virus. And investors want to step aside. But given the resilience of Chinese equities, investors should not get too negative. Moreover, as noted above, the key long-term yield curve 30Y-10Y has been resilient and arguably steepening, even as stocks have plunged.

Bottom line: I believe a V-shaped bounce is coming. The best bet is to stick with low volatility stocks. We have identified 15 low-vol stocks ranked in the top quintile of our DQM quantitative model. The tickers are LMT, JCI, CTXS, ADP, V, GL, AIV, AMT, CCI, SBAC, KO, JNJ, MRK, PPL and D.

Thomas Lee, Co-Founder & Head of Research

Figure: Comparative matrix of risk/reward drivers in 2020
Per FS Insight

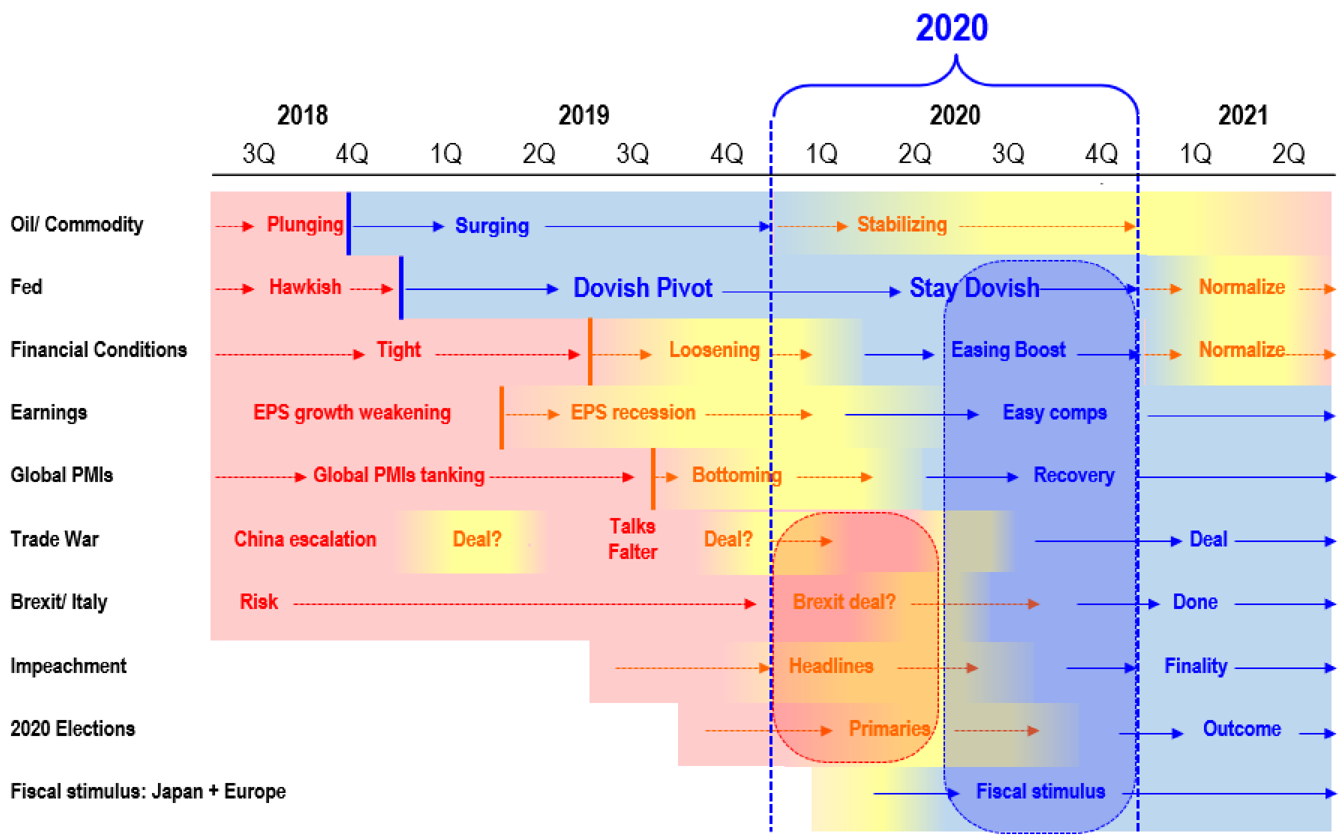


Figure: FS Insight Portfolio Strategy Summary - Relative to S&P 500
** Performance is calculated since strategy introduction, 1/10/2019

Fundstrat Theme	Execution of Strategy	Date Added	Last 3 Months: Dec	Jan	Feb	FY19 (since 1/10)	1Q20	2Q20	3Q20	4Q20	Since Inception Rel. Return
S&P 500	S&P 500 Price Index		2.9%	(0.2%)	(7.7%)	24.4%	(7.8%)	-	-	-	14.7%
			Performance relative to S&P 500…								
Granny Shot	Intersect of below investment strategy	1/10/19	1.0%	1.4%	1.1%	8.8%	2.4%	-	-	-	11.3%
Tactical — 6-12M											
1 Value / Growth Tilt	Market re-discovered valuation risk. • Growth - Cyclicals • Growth - Quality	1/10/19	1.3%	(0.9%)	1.7%	4.3%	0.8%	-	-	-	5.0%
2 Seasons the *NEW* Seasonality	Overweight groups with good seasonals. CURRENT: RE Srvcs, Oil & Gas Eqpt & Refiners, Semis Eqpt, Mg. Healthcare, Ind Mach, Online Retail, Home Entmt	1/10/19	(0.2%)	(4.6%)	0.4%	1.2%	(3.9%)	-	-	-	(3.7%)
3 PMI Recovery*	Sectors and style that benefit from PMI recovers above 50. • Tech, Industrials, Financials, Energy + Value	12/13/19	0.4%	(3.4%)	(1.2%)	0.4%	(4.3%)	-	-	-	(4.0%)
Thematic — 3-5 years											
4 Millennials prime years	Millennials driving >50% GDP growth. • Millennial transformation. • Millennial accelerates growth.	1/10/19	0.3%	2.5%	1.3%	0.5%	3.7%	-	-	-	5.1%
5 Labor shortage— AI/ automation	World is short 78 million workers. • Automation/ AI suppliers. • Beneficiaries of Automation/ AI	1/10/19	0.5%	(2.2%)	0.2%	3.4%	(1.8%)	-	-	-	0.8%
6 Higher inflation— Assets vs OpEx	Inflation trending higher long term. • Assets over OpEx.	1/10/19	(0.2%)	(1.8%)	(0.2%)	(0.6%)	(1.8%)	-	-	-	(2.8%)

Source: FS Insight, Bloomberg

@federalreserve

A Coronavirus Fed Cut? Futures Say Yes; Debate Underway

We have consistently maintained that the coronavirus outbreak, though scary and fatal for nearly 2900 so far out of 84,000 cases according to John Hopkins Center for Systems Science and Engineering, should not create panic among investors for the long term. There have been lots of nasty headlines generated and the stock market has taken a surprising 12.8% dive from all-time highs into correction territory as a result, but history does not support what we've seen so far as a serious pandemic.

Nevertheless, no one can be 100% sure of this, not even your faithful scribes in these pages. And already the debate has begun, at least in the media, about what the Federal Reserve can or should do about this virus and what effect it might have on global economic activity.

The markets have spoken. While the stock market is down big, the bond market is up big, as investors fly to safety. And the CME Fed futures market has already decided—for now. I've noted in previous issues that the Fed futures were slowly but surely moving forward the probability of a Fed cut to the Fed Funds rate. A while back it was expected to be December. A few months back it was July. Last week it went to April early on and now strong expectations for at least one rate cut at the next meeting, March 17-18, according to CME Group data. That was up from just 9% a week ago.

Wow. I believe it is a kneejerk reaction and that it will be revised back to later in the year as it becomes clear the virus spread is being contained. Time will tell.

For its part, the Fed, through policymaker comments last week, seemed to continue the line that it is watching the virus spread closely, but that it is too early to tell about the economic fallout of the coronavirus, and in particular what effect it might have on the U.S. economy given China is a major trading partner. I'm inclined to agree.

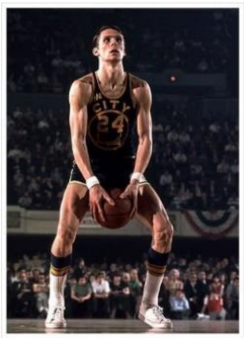
The outbreak threatens to disrupt global supply chains that run through China and threatens to further roil travel and output as it spreads to other countries, including South Korea, Japan and Italy, which have reported more cases in recent days.

Bond action suggests that investors see a relatively high chance that the Fed could cut interest rates soon. (Bond prices rise inversely to the yield.) At about 1.17% the benchmark 10-year U.S. Treasury note traded near its all-time low as global investors lowered growth expectations and sought refuge in safe-haven assets, down from 1.47% last week and 1.58% the previous week.

The CME Fed futures market is historically a good indicator of rate trends.

Upcoming: 3/17-18 - FOMC meeting. The CME futures say something will happen. I don't think so.

GRANNY SHOTS: Best bets in 2020



Below we've highlighted stocks that we recommend across at least two of our investment strategies for 2020. These companies could benefit from multiple themes and secular tailwinds – clear picks in our view for the first half of 2020.

Figure: Granny Shots are the "best of the best"
Stocks which appear in multiple themes. Source: FS Insight

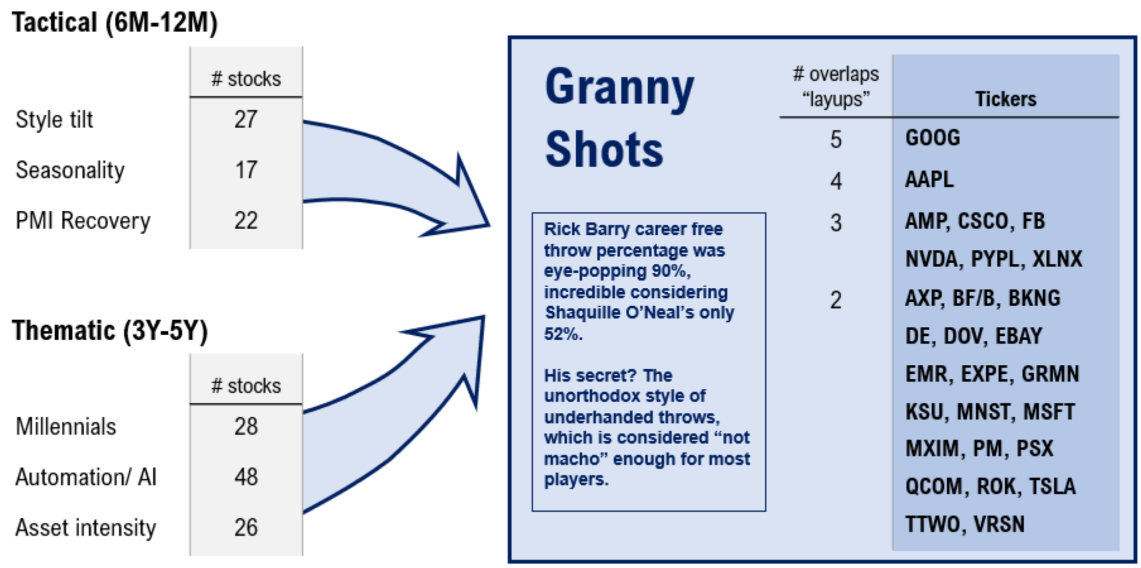


Figure: Granny Shots Portfolio Performance
Monthly. Source: FS Insight. FactSet as of 2/27/20.

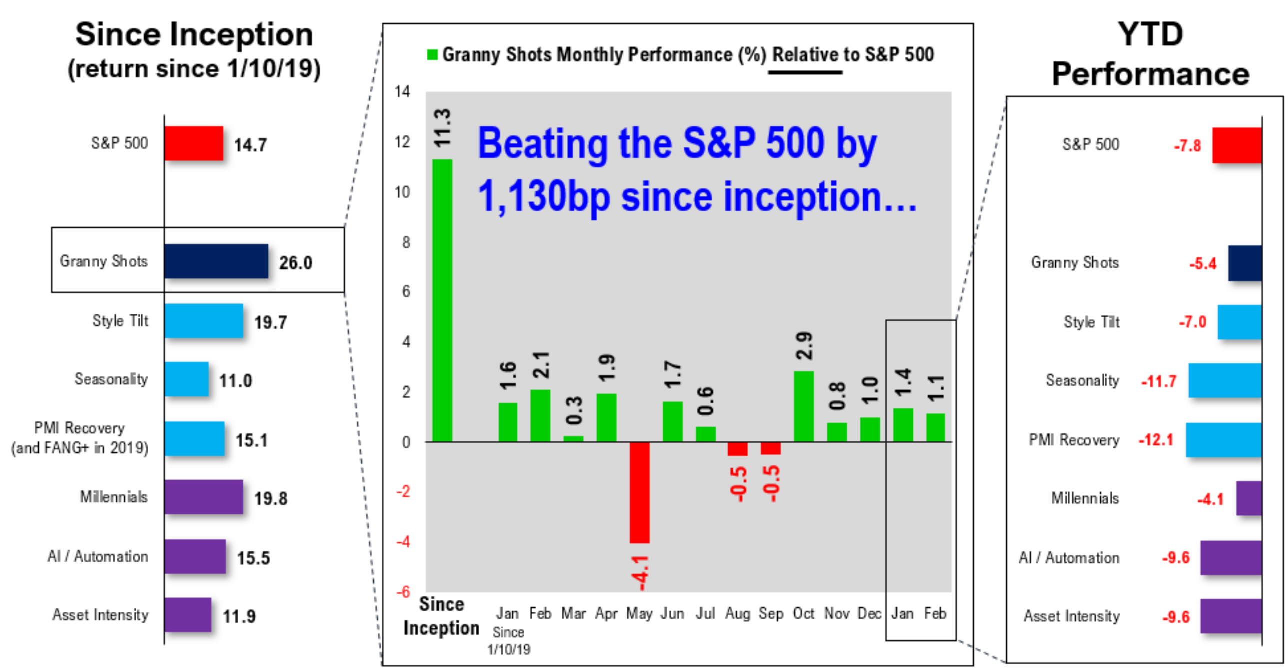


Figure: Intersection of investment recommendations by strategy
As of 2/27/20, source: FS Insight, FactSet

	Ticker	Company	Mkt Cap ($M)	YTD perf (relative to S&P 500)	P/E ('20E)	Value / Growth Tilt	Seasonality	PMI Recovery	Millennials	AI / Automation	Asset Intensity	Strategy Count
1	GOOG	Alphabet Inc	$843,790	6.4%	24.5x	•		•	•	•	•	5
2	AAPL	Apple Inc	$1,196,781	0.9%	20.1x			•	•	•	•	4
3	AMP	Ameriprise Financial Inc	$18,520	(4.4%)	8.0x	•		•			•	3
4	CSCO	Cisco Systems Inc	$169,805	(8.7%)	12.3x	•				•	•	3
5	FB	Facebook Inc	$456,490	0.2%	20.8x	•		•	•			3
6	NVDA	Nvidia Corp	$154,591	15.2%	32.1x	•		•		•		3
7	PYPL	Paypal Holdings Inc	$126,491	7.5%	31.3x	•			•		•	3
8	XLNX	Xilinx Inc	$19,780	(10.9%)	23.4x	•				•	•	3
9	AXP	American Express Co	$91,155	(1.6%)	12.5x				•		•	2
10	BF/B	Brown-Forman Corp	$29,343	0.3%	32.3x				•		•	2
11	BKNG	Booking Holdings Inc	$69,474	(11.4%)	16.4x		•				•	2
12	EBAY	Ebay Inc	$27,895	4.8%	11.6x		•				•	2
13	GRMN	Garmin Ltd	$17,025	(0.7%)	19.1x				•	•		2
14	MNST	Monster Beverage Corp	$34,272	8.1%	28.1x	•			•			2
15	PM	Philip Morris International In	$129,250	5.4%	14.9x				•		•	2
16	ROK	Rockwell Automation Inc	$21,633	(0.3%)	21.0x	•				•		2
17	TSLA	Tesla Inc	$125,200	70.1%	78.9x				•	•		2
18	DE	Deere & Co	$50,366	0.1%	16.7x			•		•		2
19	DOV	Dover Corp	$15,189	(0.9%)	16.6x		•			•		2
20	EMR	Emerson Electric Co	$39,390	(7.8%)	17.5x			•		•		2
21	EXPE	Expedia Group Inc	$13,273	(0.9%)	13.3x	•	•					2
22	KSU	Kansas City Southern	$14,648	7.3%	18.9x	•		•				2
23	MSFT	Microsoft Corp	$1,203,125	8.1%	27.9x	•					•	2
24	MXIM	Maxim Integrated Products Inc	$15,075	(1.2%)	23.9x	•		•				2
25	PSX	Phillips 66	$32,633	(25.5%)	7.8x		•				•	2
26	QCOM	Qualcomm Inc	$86,803	(6.1%)	18.2x	•				•		2
27	TTWO	Take-Two Interactive Software	$12,232	(4.1%)	24.5x	•	•					2
28	VRSN	Verisign Inc	$22,182	6.7%	35.2x	•		•				2
		Average (relative to S&P 500)	**$179,872**	**2.0%**	**22.4x**							
		Median (relative to S&P 500)	**$36,831**	**(0.1%)**	**19.6x**							

The stocks in the Granny Shots portfolio collectively outperformed the S&P 500 by 1,130 bps since its inception (S&P 500 is up 14.7% during the same period).

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Head of Technical Analysis Strategy
Former Managing Director leading RBC's U.S. Technical Research team with over 26 years of expertise in investment research and technical analysis.

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S&P Poised to Bounce at 2855 Support; See Choppy Action

It's been a rough week and I think the market is deeply oversold on a wide range of technical metrics, two in particular. Both traders and investors should be aware of these two, following this week's historic decline in equities. (For more see page 1.)

First, short-term technical indicators are at extreme levels, which have historically supported a rebound. However, while my expectation is for a trading rebound to develop from here, there is no meaningful evidence to state a bottom is developing. Every technical analyst is taught that support levels are meaningless unless price responds to those levels. The Standard & Poor's 500 index slicing through theoretical support at its 50- and 200-day moving averages is a case in point.

The next key support levels are at the 4Q19 lows, coinciding with a 50% retracement of the 2019-2020 rebound. The chart below highlights the next key support levels for the SPX that I'm watching for some evidence that the equity market will stabilize.

Interestingly, as I write this note on Friday, the SPX has touched and bounced from its next important support level at its 4Q19 lows at 2855, which is just below a 50% retracement (2870) of the current bull cycle that began in 4Q 2019. I expect this level to hold but should it fail, then the next support is at the August 2019 lows of 2822, followed by a more important support band at the June 2019 2728 lows, just below the 62% retracement at 2746.

Lastly, the rising 200-week moving average (2629) remains an important long-term support level that has historically defined significant cycle lows. I am not expecting a retest of that level but it remains a level to watch.

S&P 500 – Weekly

Source: FS Insight, Bloomberg

Why are the weekly momentum indicators important? I rely heavily on intermediate-term/weekly indicators to track and forecast equity market shifts over a 1-2 quarter time frame. They were helpful anticipating a 4Q rebound with our forecast targeting a mid-late February peak followed by choppy trading range well into and possibly through 2Q. While the expectation for a mid-late February peak proved correct, I failed to anticipate such a dramatic decline.

What now? My expectation is that markets will begin a short-term bottom process near current levels but investors should brace for months of backing and filling/choppiness before the market establishes a more sustainable bottoming pattern.

Figure: Weekly Sector Review
Source: FS Insight, Factset

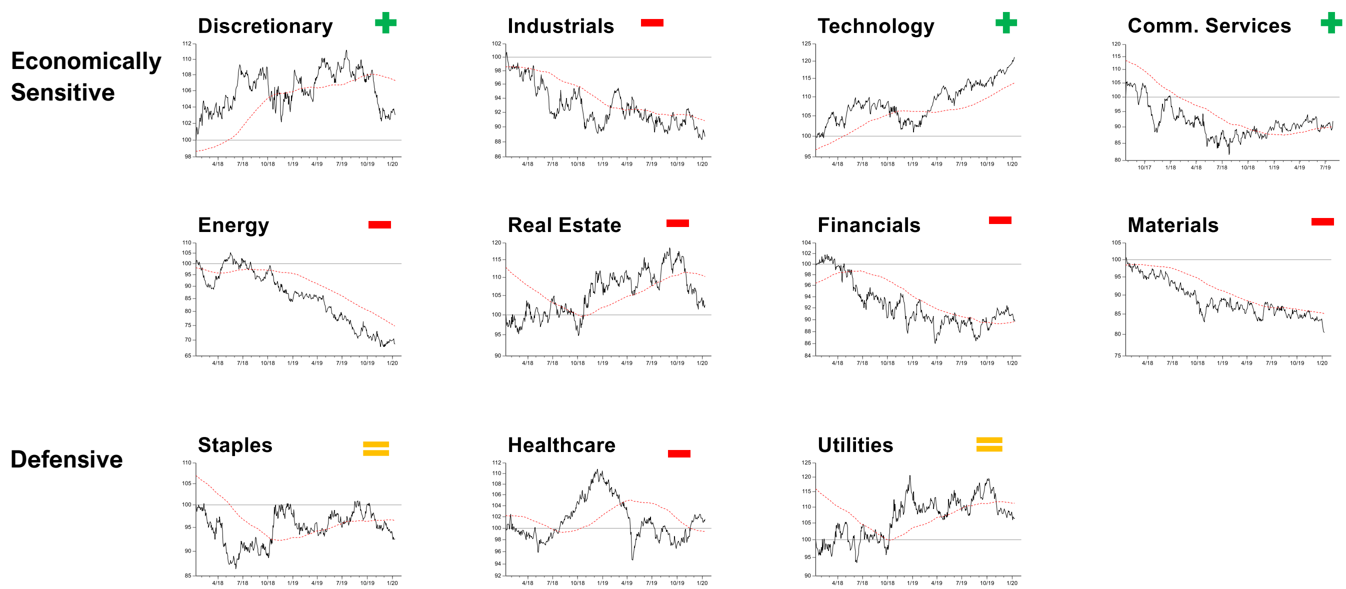
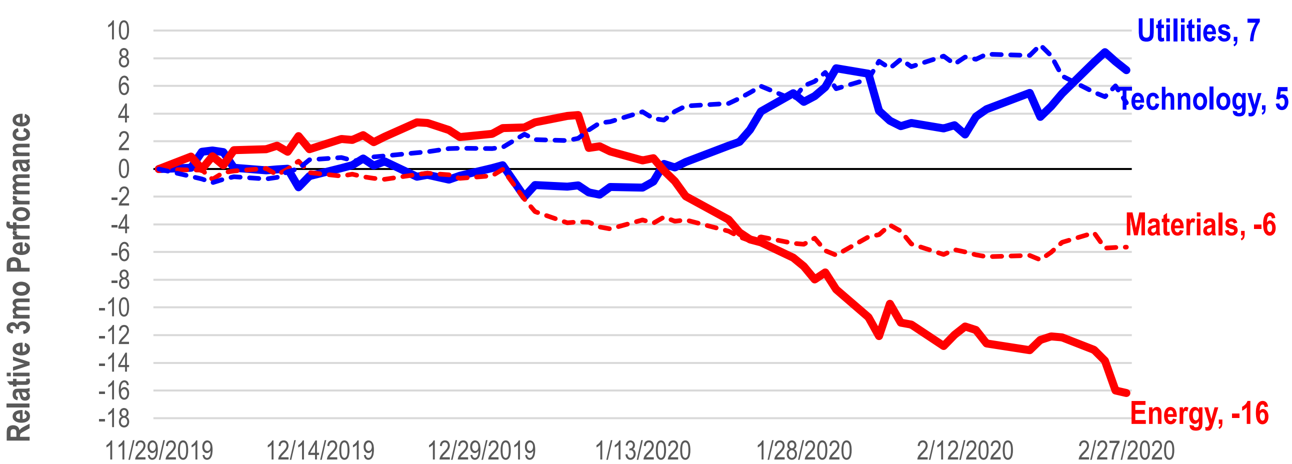
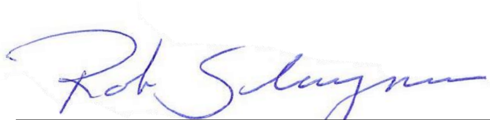


Figure: Best and worst performance sectors over past 3 months



Source: FS Insight, Bloomberg



Robert Sluymer, Head of Technical Analysis Strategy

L. Thomas Block
Washington and Policy Strategist
Formerly Global Head of Government Relations at J.P. Morgan for 21 years, and previously served as Legislative Assistant and Chief of Staff in the House, and Legislative Staff Director in the Senate

@TomBlock_FS

S. Carolina, Super Tuesday Votes Crucial for Dem Contenders

The U.S. political world is focused on Feb. 29th's South Carolina primary vote, and Tuesday's primaries in 14 other states, despite the cloud of the coronavirus hanging over Washington. While there are only 60 cases reported so far in the U.S., some believe there is a threat of a pandemic hitting the U.S. and allege that the Administration has faltered in its first steps.

South Carolina

After setbacks in the first three primaries, former Vice President Joe Biden is set for a must-win decision by the Democratic voters in South Carolina vote Saturday. He has counted on a deep reservoir of goodwill among African-American voters to save his candidacy in a state where 60% of the Democratic primary voters are black.

After a solid performance in this past week's debate, and the critical endorsement of South Carolina's most influential African-American Congressman James Clyburn, Biden has built a double-digit lead over Senator Bernie Sanders in the most recent polling. A Biden victory may not turnaround his stumbling campaign, but it does give him a lifeline to survive until Super Tuesday.

Super Tuesday

One-third of all delegates to the Democratic convention will be chosen in the contests this Tuesday, March 3, in 14 states, including California and Texas. Tuesday will also mark the first day former New York City Mayor Michael Bloomberg's name appears on the ballot, and voters will decide if his performance in this week's debate was good enough to give him a second look after his disastrous first debate.

Senator Bernie Sanders is polling very well in both California and Texas, and Biden has not had the financial resources to either air commercials or employ staff in the key states. It is a big question mark if any of the moderate alternative candidates can remain a viable alternative to Sanders after Super Tuesday. Second place in these races could tell who emerges as the moderate rival to Sanders.

Coronavirus

The President's press conference Wednesday night lacked clarity and leadership. Reports of healthcare leaders being muzzled, whistle blowers being punished and blaming the press for scaring the public doesn't appear to be the prescription for dealing with the growing crisis.

A national emergency can give a President the chance to truly demonstrate leadership, but it also poses great risk especially in an election year when job performance is on the line. The coming weeks will pose a new level of both risk and reward for the Trump Administration.

L. Thomas Block, Washington and Policy Strategist

Figure: Top Trump Tweets

Donald J. Trump
The 45th President of United States of America

@realDonaldTrump

Economic Calendar

From 03/02/2020 – 03/06/20

NEXT WEEK'S MAJOR U.S. ECONOMIC REPORTS & FED SPEAKERS			
TIME (ET)	**REPORT**	**PERIOD**	**PREVIOUS**
MONDAY, MARCH 2			
9:45 AM	MARKIT MANUFACTURING PMI	FEB.	50.8
10 AM	ISM MANUFACTURING INDEX	FEB.	50.9%
10 AM	CONSTRUCTION SPENDING	JAN.	-0.2%
TUESDAY, MARCH 3			
VARIES	MOTOR VEHICLE SALES	FEB.	16.8MLN
WEDNESDAY, MARCH 4			
8:15 AM	ADP EMPLOYMENT REPORT	FEB.	291,000
9:45 AM	MARKIT SERVICES PMI	FEB	49.4
10 AM	ISM NONMANUFACTURING INDEX	FEB.	55.5%
2 PM	BEIGE BOOK		
THURSDAY, MARCH 5			
8:30 AM	WEEKLY JOBLESS CLAIMS	2/29	
8:30 AM	PRODUCTIVITY	Q4	1.4%
8:30 AM	UNIT LABOR COSTS	Q4	1.4%
10 AM	FACTORY ORDERS	JAN.	1.8%
FRIDAY, MARCH 6			
8:30 AM	NONFARM PAYROLLS	FEB.	225,000
8:30 AM	UNEMPLOYMENT RATE	FEB.	3.6%
8:30 AM	AVERAGE HOURLY EARNINGS	FEB.	0.2%
8:30 AM	TRADE DEFICIT	JAN.	-48.9BLN
10 AM	WHOLESALE INVENTORIES	JAN.	-0.25
3 PM	CONSUMER CREDIT	JAN.	$22BLN

Source: Marketwatch

Disclosures

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