Thomas J. Lee, CFA
inquiry@fsinsight.com
8/14/2020

COVID-19 UPDATE: Raising S&P 500 Target to 3,525 (+75 vs prior), reflects epicenter rally to add +150 points upside

THIS MESSAGE IS BEING SENT SOLELY TO CLIENTS OF FS INSIGHT

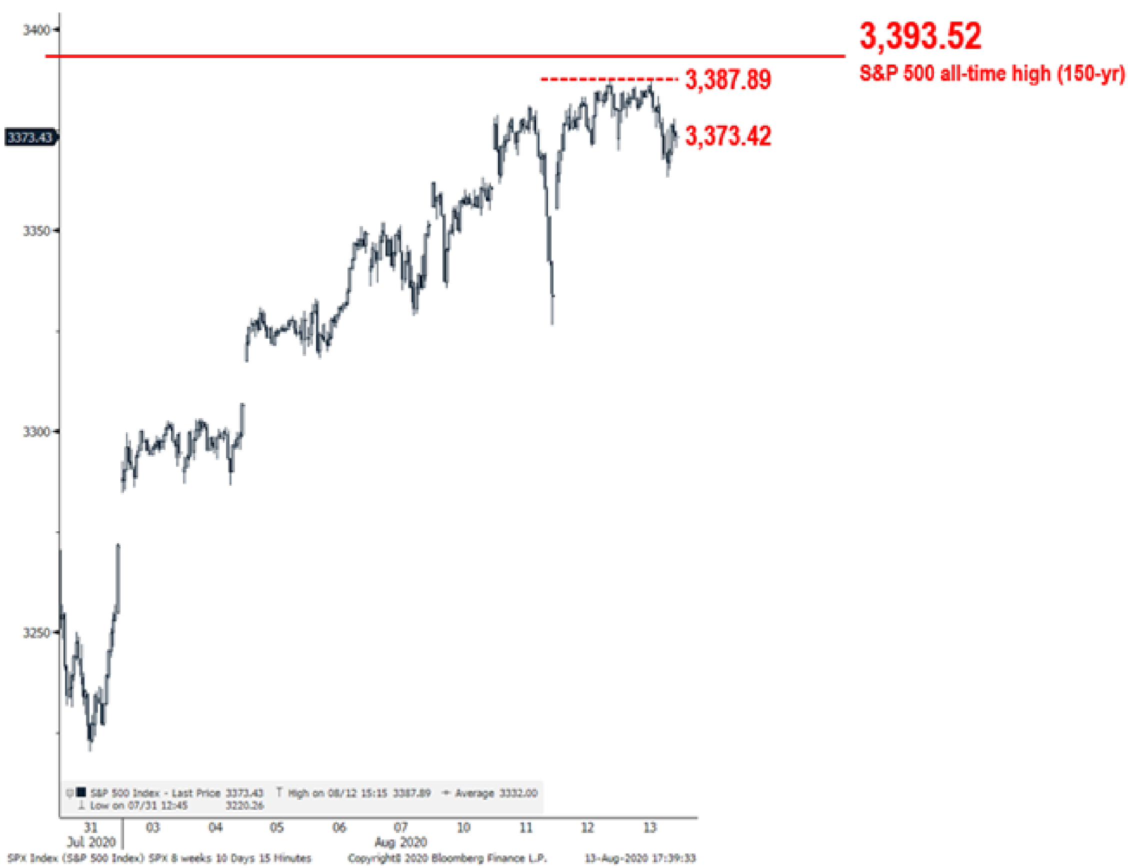
STRATEGY: Epicenter upside = 150 points --> S&P 500 YE Target now 3,525 (+75)

Hovering near all-time highs...

The key level for the S&P 500 is 3,393.52, the Feb highs, and which is also the all-time high (ATH, also, it's a 150-year high, for exaggeration purposes). This week, the equity market has struggled as we near this key level. Several times this week, the S&P 500 touched 3,387.89, which is a mere 5 points from an ATH. From our vantage point, this is just a waiting game. That is, we believe there are catalysts to support a move well beyond 3,393.52.

The headwinds that are developing this week are Washington is stumbling on a fiscal package and the impasse does not seem to be improving. And perhaps to a lesser extent, interest rates are creeping higher and at some point, this will cause investors to be nervous.

- in our view, we believe if the S&P 500 re-attains 3,393.52, we will see a very fast move to >3,500
- this breakout to ATH would validate a new bull market is underway, with themes and drivers related to "move assets back to America"



Thomas J. Lee, CFA
inquiry@fsinsight.com
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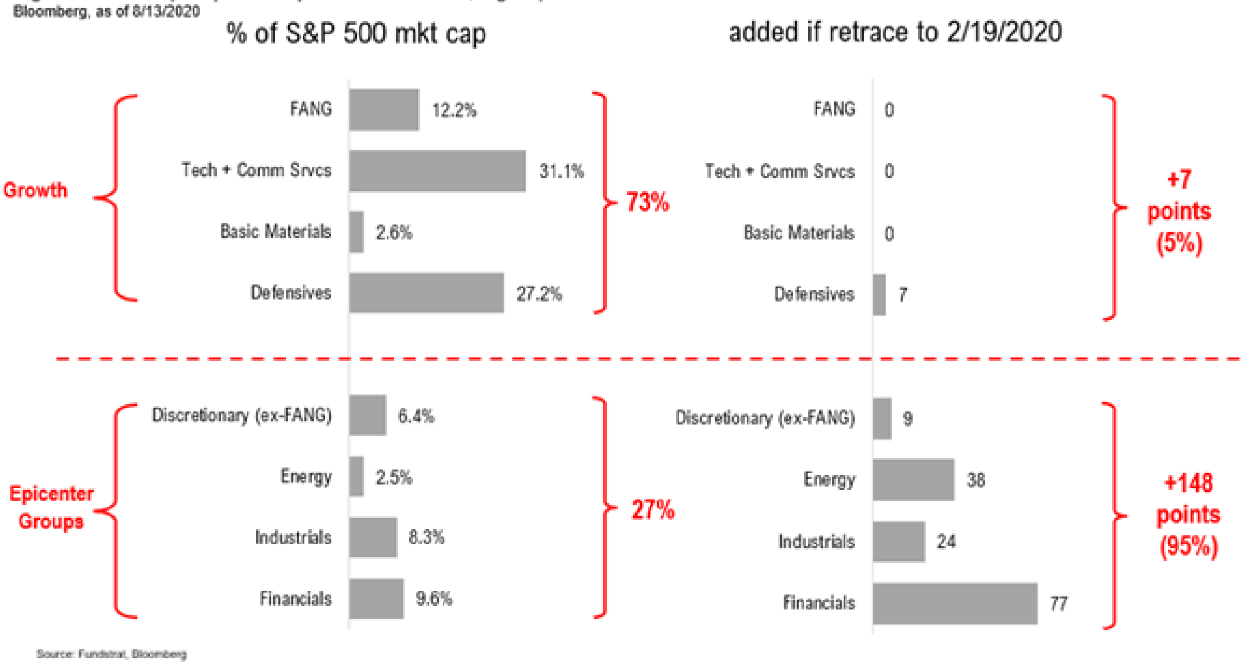
Raising YE Target to 3,525 to reflect 150 point upside from epicenter stocks...
We are raising our YE target for S&P 500 to 3,525 (vs 3,450 previously) and this represents +150 points upside. The rationale for our upgrade is straight forward:

- A new economic expansion underway (so make sense to be long equities)
- Bond proxies/FANG are cheap at 25X-30X vs investment grade bonds at 52X, so we do not see the downside
- Bond proxies are 74% of equity market cap
- If the "Epicenter stocks", those hardest hit by the pandemic, return to Feb 2020 highs, that adds +150 points

Thus, the 150 point upside we see for the S&P 500 into YE is primarily driven by a rise in the epicenter groups. We have written extensively about the drivers for the epicenter stocks, and in this commentary, we speak about the cost rationalization taking place. Take a look below:

- these 4 sectors, Industrials, Financials, Energy and Discretionary, could add 148 points if they recover to their Feb 2020 levels;
- these 4 sectors were already off their all-time highs, thus, this move is not a move to ATH

Figure: Market cap vs potential points contribution, if groups retrace 100% of losses since Feb 2020
Bloomberg, as of 8/13/2020



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Below are the 20 stocks (*) that our teams see as a trifecta -- they are OW (Overweight) rated:

- Brian Rauscher, Head of Global Portfolio Strategy
- Rob Slumyer, Head of Technical Strategy
- DQM model ranked quintile 1

Ticker	Company name	Sub-industry name	Current Price	Market Cap ($mm)	DQM Quintile 1	Brian Rauscher	Robert Sluymer
BWA	Borgwarner Inc	Auto Parts & Equipment	$40.96	$8,489	OW	OW	OW
AN	Autonation Inc	Automotive Retail	56.58	4,935	OW	OW	OW
BBY	Best Buy Co Inc	Computer & Electronics Retail	107.90	27,872	OW	OW	OW
TGT	Target Corp	General Merchandise Stores	134.81	67,407	OW	OW	OW
PHM	Pultegroup Inc	Homebuilding	45.52	12,207	OW	OW	OW
MNST	Monster Beverage Corp	Soft Drinks	83.82	44,206	OW	OW	OW
REGN	Regeneron Pharmaceuticals In	Biotechnology	610.89	64,994	OW	OW	OW
MOH	Molina Healthcare Inc	Managed Health Care	193.02	11,446	OW	OW	OW
OC	Owens Corning	Building Products	67.65	7,307	OW	OW	OW
CAT	Caterpillar Inc	Construction Machinery & Heavy	140.67	76,174	OW	OW	OW
PNR	Pentair Plc	Industrial Machinery	45.23	7,504	OW	OW	OW
TKR	Timken Co/The	Industrial Machinery	55.14	4,141	OW	OW	OW
CFX	Colfax Corp	Industrial Machinery	34.55	4,090	OW	OW	OW
GWW	Ww Grainger Inc	Trading Companies & Distributo	352.07	18,861	OW	OW	OW
JBL	Jabil Inc	Electronic Manufacturing Servi	34.83	5,244	OW	OW	OW
AMD	Advanced Micro Devices Inc	Semiconductors	81.84	96,085	OW	OW	OW
XLNX	Xilinx Inc	Semiconductors	105.50	25,775	OW	OW	OW
OLED	Universal Display Corp	Semiconductors	188.55	8,881	OW	OW	OW
MOS	Mosaic Co/The	Fertilizers & Agricultural Che	17.46	6,619	OW	OW	OW
RS	Reliance Steel & Aluminum Co	Steel	105.66	6,737	OW	OW	OW

Source: Fundstrat, Bloomberg

(*) Please note that the stocks rated OW on this list meet the requirements of our investment theme as of the publication date. We do not monitor this list day by day. A stock taken off this list means it no longer meets our investment criteria, but not necessarily that it is neutral rated or should be sold. Please consult your financial advisor to discuss your risk tolerance and other factors that characterize your unique investment profile.

Thomas J. Lee, CFA
inquiry@fsinsight.com
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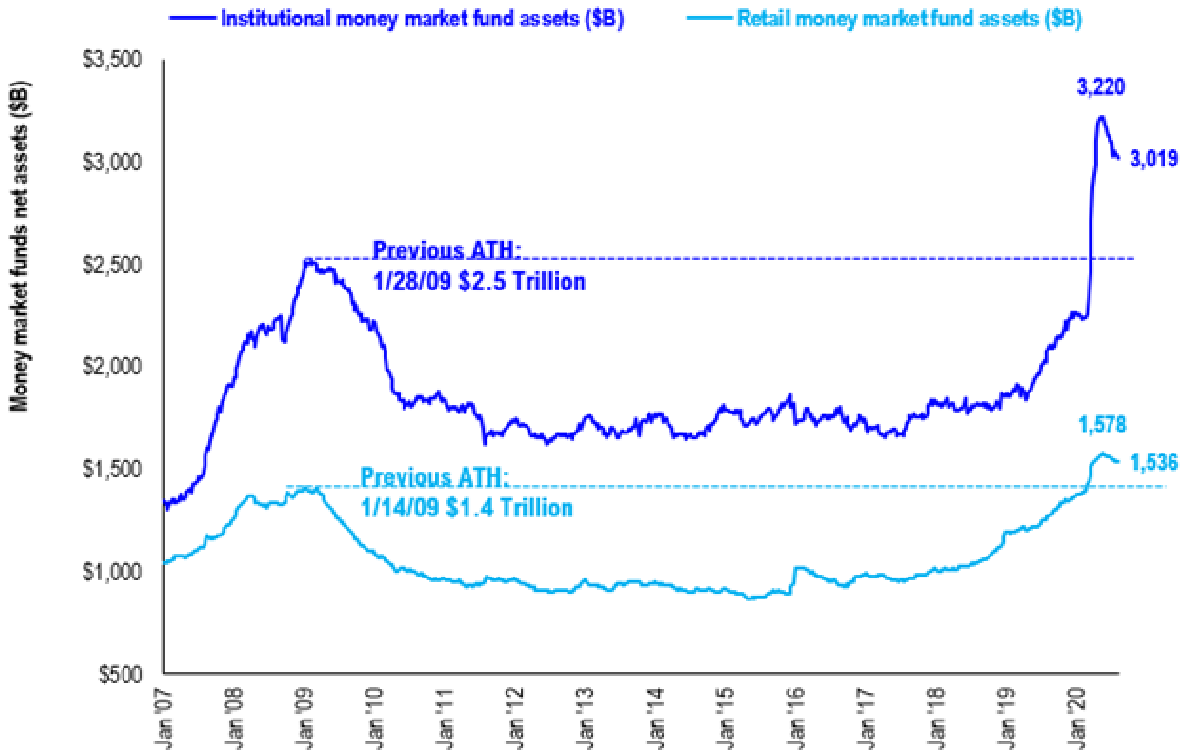
Many investors see the "ceiling" for upside at Feb 2020 highs...
This week, in many of our Zoom meetings, we sensed an elevated level of caution by investors. We are oversimplifying, but we get the sense that most investors see the equity ceiling as the Feb highs. At that level, most seem to become sellers. However, keep the following in mind:

- investors are unusually cautious given markets are at new highs, even reflected in bearish AAII readings -- not a sign of a top
- $4.5 trillion of cash on the sidelines -- not a sign of a top
- the economy bottomed and is expanding -- not a sign of a top
- Fed is "easy" - not a sign of a top (only when they become hawkish)

Seriously, look at this cash on the sidelines. Could markets really be "topping" with ~$5 trillion on the sidelines? I don't know if this ever happened in history, of the World. In fact, coupled with a Fed remaining dovish, how can one argue stocks are done?

Figure: Institutional and retail money market fund assets
Since 2007



Source: Fundstrat, Bloomberg, ICI

Thomas J. Lee, CFA
inquiry@fsinsight.com
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Moreover, take a look below. We believe there are 5 reasons we expect S&P 500 to fully recover and blast to new highs.

2020: Why stocks will recover

	Description	Impact
Disease	5th US pandemic since 1900	US recovered every time
Economy bottomed	US economy already bottomed	Stocks bottom ***before*** economy bottoms
V-shape	Stocks always V-shaped recovery	S&P 500 could make all-time high in Summer 2020
Cost cutting	Companies cut costs in recession	2021 EPS $190 or higher
Fed	"whatever it takes"	"don't fight the Fed"

And we see 3 drivers to this new bull market. We have covered these themes in the past and also in past webinars. So, we will not go into too much detail. But the center of this view, is post-pandemic, we are going to see 3 structural changes that drive new capital investment:

- assets de-globalize and become local supply chains
- Americans leave the urban areas for the suburbs --> capex
- More Americans work from home --> invest in home office --> capex

So you can see this capital spending cycle. There will be capital lost, but that is expected. Losses are generated. And the "second owner" of a hotel makes money.

Figure: Way forward → What changes after COVID-19
Per Fundstrat best guess

Structural Change	Rationale	Stranded Capital	New Capital
1. **Supply chain moves back to USA**	From China → USA	Foreign factories Foreign supply chains	Domestic factories Domestic supply chains
2. **De-urbanization**	Cities → suburbs	Urban restaurants Urban shopping City-centric services	Housing + furnishing Infrastructure Home entertainment Home delivery Suburban entertainment Suburban amenities
3. **Work from home**	Office → home	Office space midtown/ urban office services	Home technology Home furnishings
4. **Buy USA**	Global →USA	Foreign-based asset	US based assets

Source: Fundstrat, Bloomberg, Factset

Thomas J. Lee, CFA
inquiry@fsinsight.com
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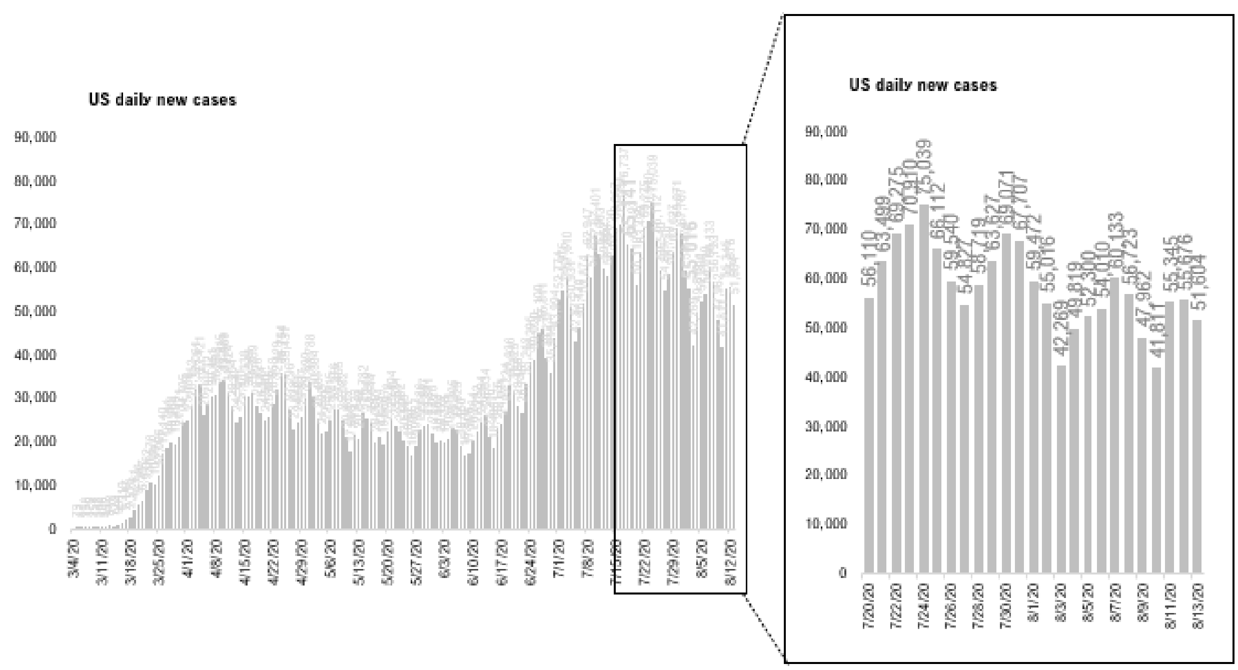
And let's not forget there remains serious negative anchoring bias. These are the 6 anchoring biases we see below.

Understanding "negative bias"

- Disease is terrifying and killing hundreds of thousands
- Economy facing worst Depression in 5 lifetimes and worse than even "the Great Depression"
- Stocks moved at lightning speed but economy at stall speed
- White House polarizing and muddies policy adoption
- Generational conflict: Baby Boomers vs Millennials
- "Macro" thought leaders extremely bearish

POINT 1: Cases are falling, even without adjusting for the massive CA backlog...

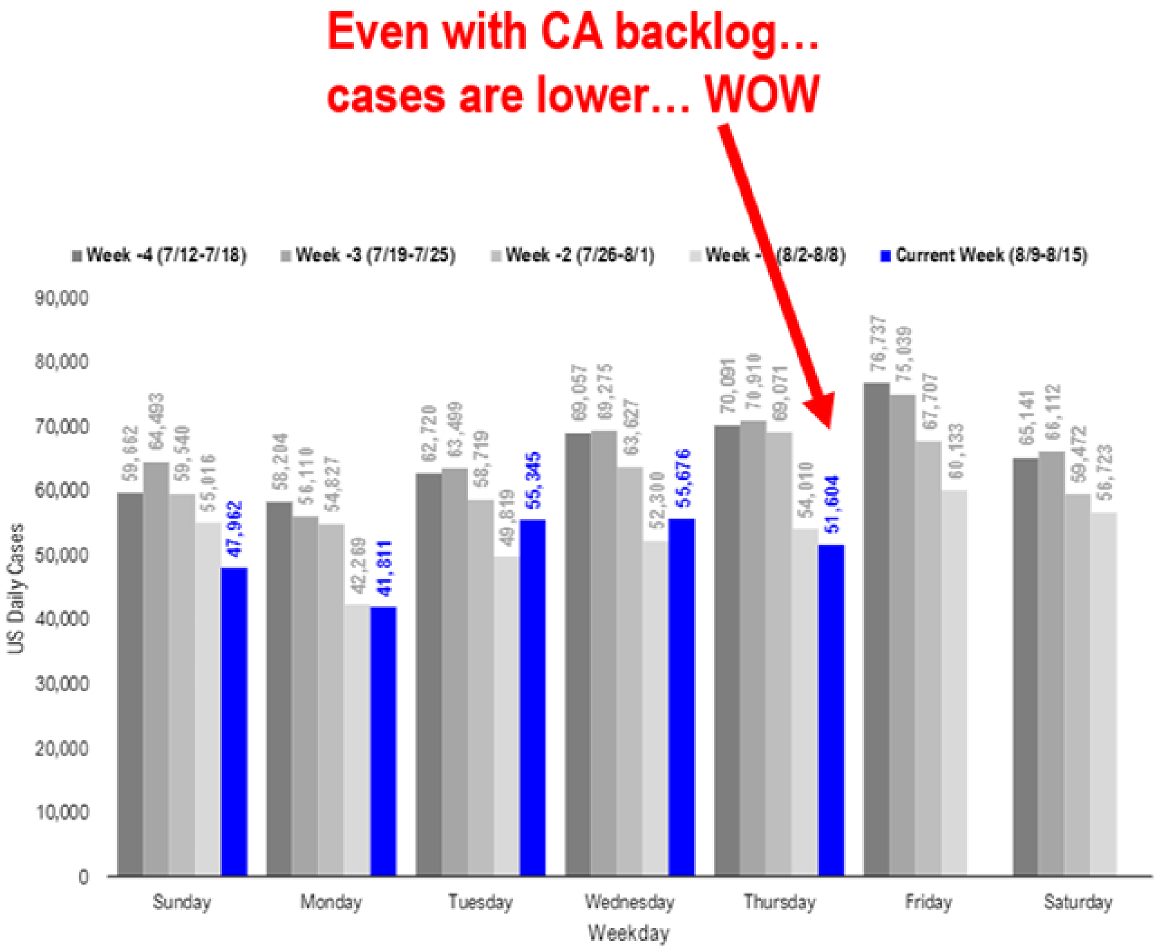
Daily cases in the US are falling, which is a good thing. And even with CA polluting data because of a massive backlog, daily cases are down on a 7D basis. On Thursday, testing reached a nearly all-time high of nearly 900,000, so weaker testing is not a valid argument, despite many suggesting this.



Source: COVID-19 Tracking Project

There is pronounced seasonality in the daily case data. So, looking at each weekday, we can see the "polluting" effect from CA, which caused Monday, Tuesday and Wednesday to be above last week.

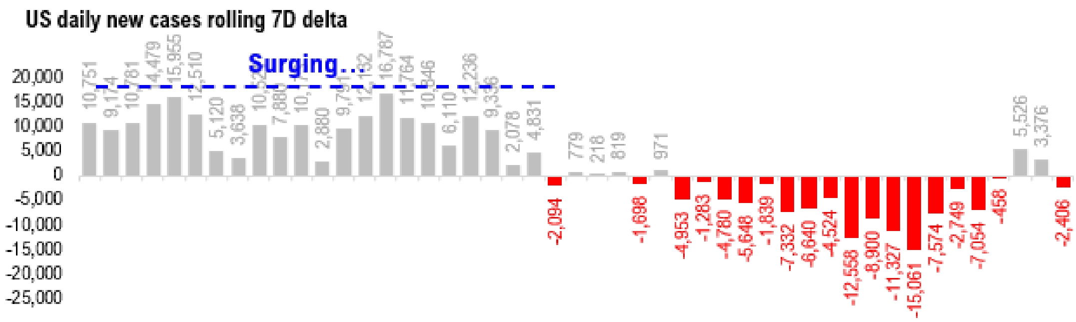
- But even with CA, Thursday is lower.

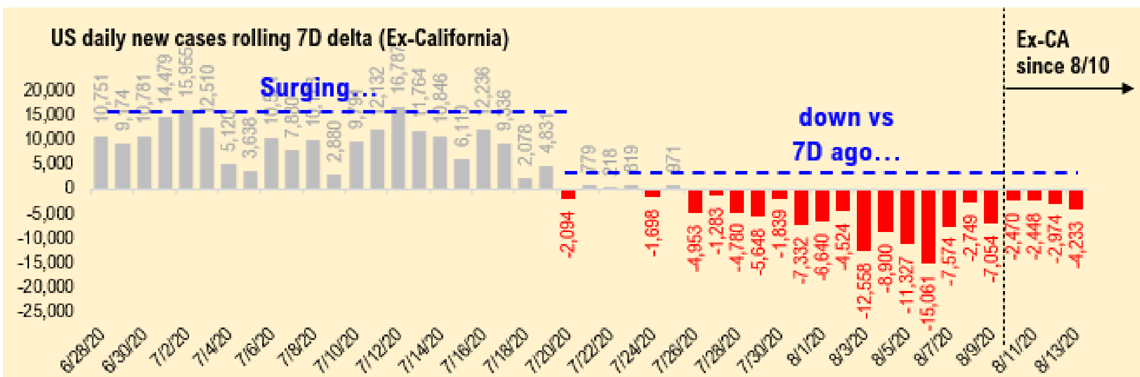


Source: COVID-19 Tracking Project

Thomas J. Lee, CFA
inquiry@fsinsight.com
8/14/2020

Daily cases compared to 7D ago remains our preferred way to track trends. And as shown below, ex-CA, daily cases are falling sharply. But even with CA included, daily cases are down.





Source: COVID-19 Tracking Project

CA is up vs 7D but look at the rest of the states, completely benign levels of increase.

6 states with largest 7D delta in daily cases

California	7,085 vs 5,258	+1,827
Michigan	1,121 vs 722	+399
Virginia	1,101 vs 818	+283
New Jersey	656 vs 374	+282
Kentucky	741 vs 513	+228
Missouri	1,267 vs 1,062	+205
Total		+3,224

And in FL and TX, cases are crashing.

6 states with largest 7D delta in daily cases

Florida	6,236 vs 7,650	-1,414
Alabama	771 vs 1,938	-1,167
Texas	6,755 vs 7,598	-843
Georgia	2,515 vs 3,182	-667
South Carolina	935 vs 1,325	-390
Mississippi	612 vs 956	-344
Total		-4,825

Thomas J. Lee, CFA
inquiry@fsinsight.com
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Daily Case Increases (by State) (08/13)

% total new cases (state cases/ total US cases)
% total US pop (state population/ total US population)

Sorted
Last 3-day trend growth rates

	8/11/20	8/12/20	8/13/20	
United States	55,345	55,676	51,604	-4,072
United States (ex-CA)	42,845	44,031	44,519	+488
States:				
California	12,500	11,645	7,085	
Texas	9,803	6,200	6,755	
Florida	5,831	8,109	6,236	
Georgia	3,563	3,565	2,515	
Tennessee	1,001	1,478	2,118	<--higher
Illinois	1,549	1,645	1,834	
North Carolina	1,051	1,166	1,763	<--higher
Arizona	1,214	706	1,351	
Missouri	981	1,595	1,267	
Ohio	1,095	1,422	1,178	
Louisiana	1,164	1,179	1,135	
Michigan	796	515	1,121	<--higher
Virginia	996	776	1,101	
Indiana	870	660	1,043	
Pennsylvania	828	849	991	
Wisconsin	724	478	943	<--higher
South Carolina	971	844	935	
Maryland	585	541	776	<--higher
Alabama	831	935	771	
Kentucky	539	1,152	741	
New York	667	700	737	
Oklahoma	765	670	705	
Minnesota	323	464	690	<--higher
New Jersey	444	463	656	<--higher
Arkansas	383	703	652	
Mississippi	644	1,081	612	
Nevada	548	528	602	
Washington	575	504	551	
Iowa	258	477	530	
Idaho	495	538	498	
Colorado	402	315	463	
Nebraska	334	214	416	<--higher
Hawaii	118	202	354	<--higher
Utah	362	338	334	
Massachusetts	392	293	319	
Oregon	286	248	278	
Delaware	65	66	202	<--higher
North Dakota	172	85	201	
New Mexico	199	173	171	
West Virginia	121	133	143	
Montana	83	175	142	
Rhode Island	119	76	111	
Puerto Rico	286	564	110	
South Dakota	50	102	82	
Alaska	46	60	82	<--higher
Connecticut	117	22	76	
District of Columbia	89	63	65	
U.S. Virgin Islands	29	63	43	
New Hampshire	21	26	34	<--higher
Wyoming	31	13	33	
Guam	16	15	28	
Maine	1	20	19	
Vermont	12	5	6	
Northern Mariana Islands	0	0	0	
Kansas	0	817	0	
American Samoa	0	0	0	

Source: COVID-19 Tracking Project

Thomas J. Lee, CFA
inquiry@fsinsight.com
8/14/2020

POINT 2: Testing is still strong, so fall in cases is real...

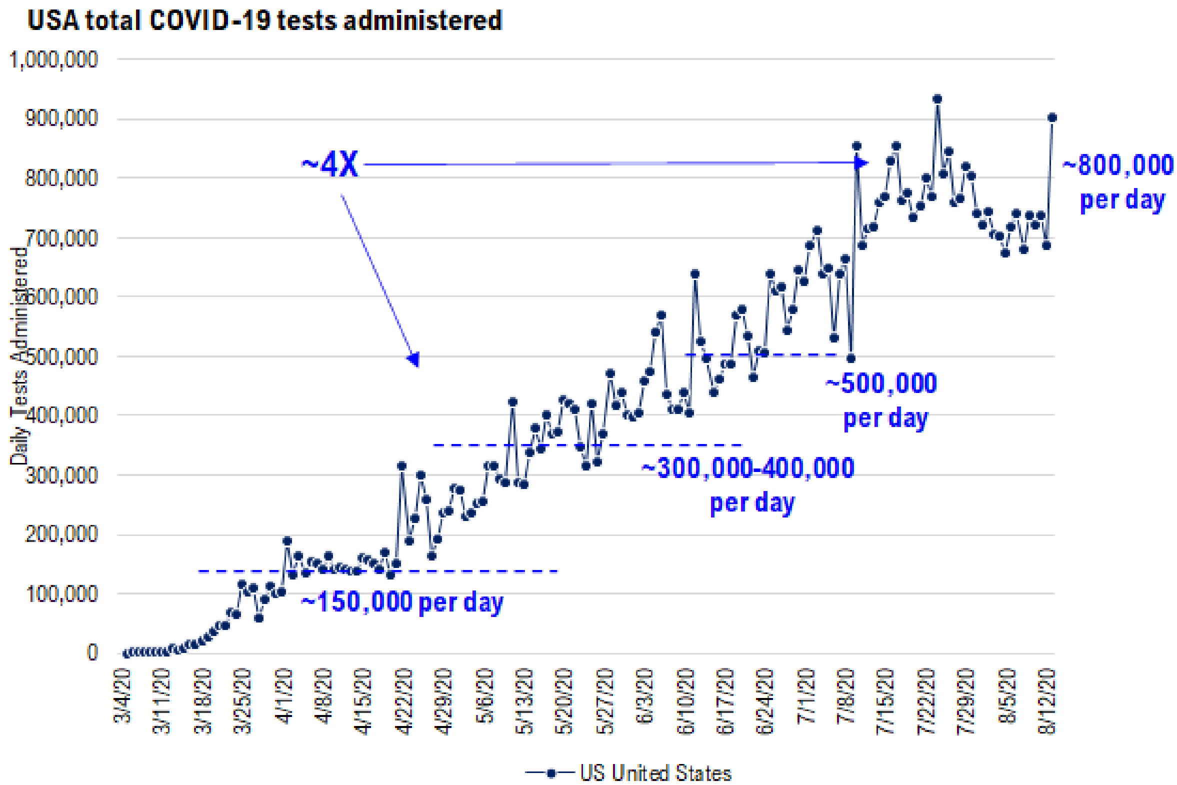
A few clients asked us if the fall in cases is primarily due to falling testing. This is an argument put forth by some media outlets, and we disagree with this assertion. Foremost, testing is a "pull" function, meaning few are subject to forced testing (essential workers, etc.). Thus, the only people seeking testing are:

- sick
- in contact with someone sick
- tested due to work

If testing is falling, it is not due to the work-related testing. It is due to fewer people seeking testing, in our view.

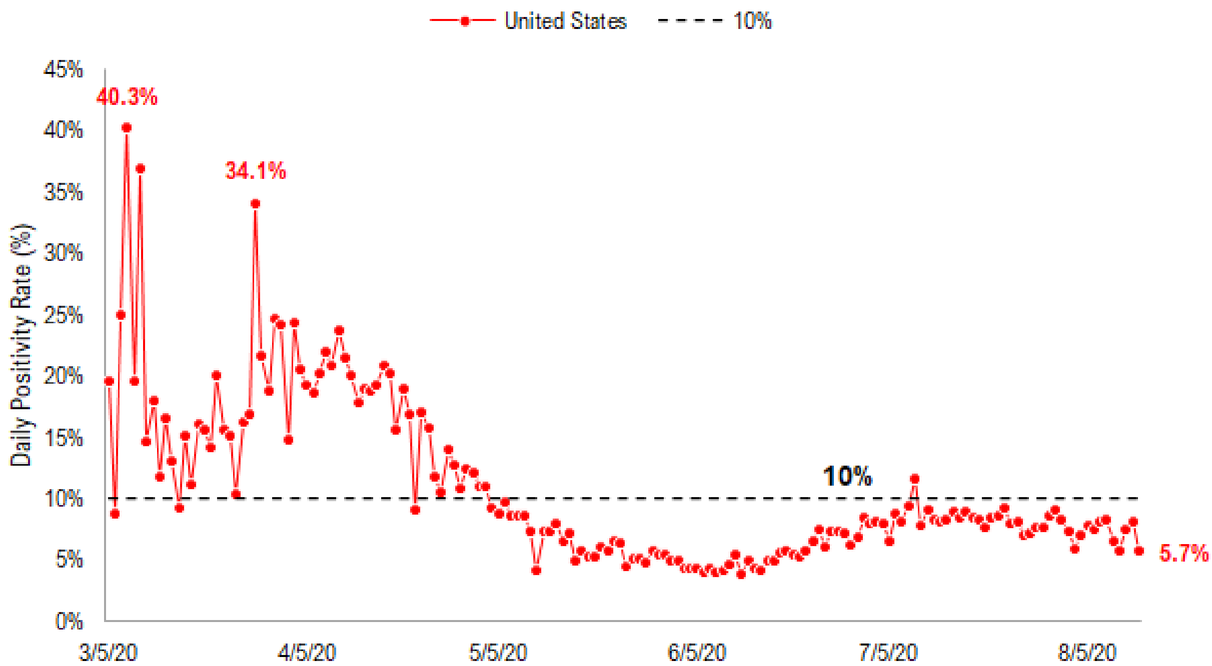
By the way, testing soared to a new high yesterday. And as shown, this level of tests is the second highest ever.

- despite this, cases are much lower yesterday on a seasonally strong day. Cases on Thursday and Friday are the highest in a typical week.



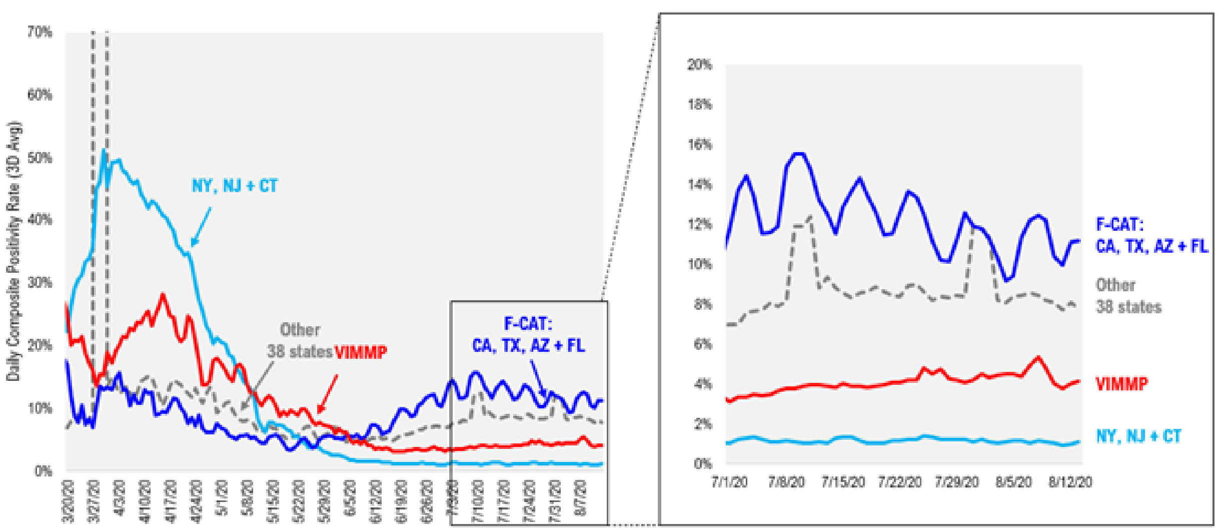
Source: COVID-19 Tracking Project

Similarly, positivity rates are collapsing. This is the lowest print since early June. Think about that. Positivity rates for the US are approaching 5%.



Source: COVID-19 Tracking Project

Take a look at the worst hit areas, FL, CA, AZ, TX, or F-CAT, the positivity rate is trending lower in these states. And in fact, is falling in even the next potential hotspots, VA, IL, MD, MI, PA, or VIMMP.



Source: COVID-19 Tracking Project

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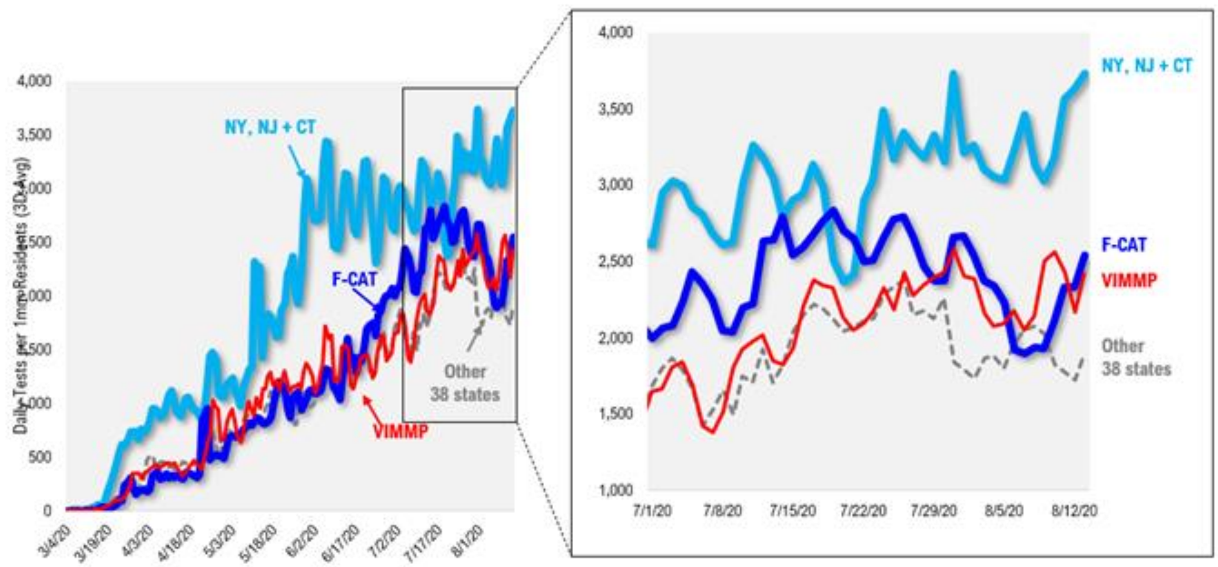
inquiry@fsinsight.com

By the way, testing in F-CAT is surging! So, it is not like F-CAT is seeing falling cases due to falling testing per-capita. As you can see below, it has absolutely soared since early August.

Daily Tests per 1mm Residents (3D Avg)



Source: COVID-19 Tracking Project

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inquiry@fsinsight.com
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POINT 3: Many "epicenters" rationalized costs dramatically to lower "breakeven" levels...
We spoke recently about how the following 5 groups are binary plays on a vaccine. If a cure/vaccine is developed, the demand for these industries will recover sharply. This is fairly intuitive.

NEW NORMAL: Binary effects from a Vaccine/Cure

Industry	COVID-19 Impact	Vaccine/ Cure Impact	Long-term issues
Airlines			Vaccine/ Cure = Full recovery
Cruises			Vaccine/ Cure = Full recovery
Casinos			Vaccine/ Cure = Full recovery
Hotels			Vaccine/ Cure = Full recovery
Theme Parks			Vaccine/ Cure = Full recovery

But these industries have also rationalized costs dramatically.

- we have listed 10 examples below
- key takeaway --> companies rationalized costs and make $$$ at much lower utilization rates
- if demand recovers, profits could be even greater, due to massive operating leverage

This is why we see the upside to the epicenter stocks.

10 examples of how these hardest hit companies lowered their cost structure...
We asked our summer intern, CJ Woodberry, a Dartmouth CS undergrad, to review the 2Q2020 earnings transcripts and look for commentary on how companies have rationalized and reduced their existing cost structure. Here are some anecdotes:

- Wynn Resorts (WYNN): Profitable at 40% of prior levels...
"we have made certain OpEx adjustments with a focus on non-labor fixed cost. As a result, we anticipate that we will break even at approximately 40% of Q4 2019 gaming volumes."

- Las Vegas Sands (LVS): Singapore breakeven...
"Yes, it is [possible to see Marina Bay Sands back toward a break-even level in the near term]. Very much so. ...It's going to be a nice turnaround." (Marina Bay Sands is located in Singapore)"

- MGM Resorts (MGM): Cut expenses 85%
"we reduced 85% of our operating expenses. And as we reopen, we are managing variable labor to closely match demand… we believe we can reduce our overall domestic operating and corporate costs by approximately $450 million compared with the 2019 levels"

- Six Flags (SIX): Profitable at 25% of usage of parks, currently at 40% for open parks...
"Our parks, generate cash flow in excess of their variable costs at significantly less than 25% of their maximum capacity. In these non-surge states... on days, we're in the mid to high 40s versus prior year. We're more than breakeven on the parks, that are open."

- Marriott International (MAR): Lowered breakeven by 3-5 percentage points
"We've been able to reduce current break-even profitability rate at our hotels around the world by 3 to 5 percentage points of occupancy to help our owners preserve cash."

- Delta Airlines (DAL): Cut OpEx by 72%
"In June, our daily cash burn for the month averaged $27 million a day, a substantial improvement from the $100 million per day that we were experiencing in late March. The major force in that improvement is our cost performance which has been remarkable as we'll take out over 50% of our total operating expenses for both the June and September quarters." (Expected June daily cash burn was $50 million)"

- Norwegian Cruise Lines (NCLH): Breakeven at 40%-60% capacity
"We have made significant progress in reducing our controllable cash burn, with our target representing an over 60% reduction in our combined ship operating expense and SG&A versus normalized levels...

When you look at... the ship operating expenses based on our... 2019 or 2020 planned levels, we would need about 40% of our typical revenue to cover the vessel operating expenses. When you layer on your corporate overhead into that, that goes up to about 60%... Obviously, certain ships, it might be lower than that and certain ships it may be higher than that. But generally speaking, it's about that 40% and 60%."

- Carnival Cruise Lines (CCL): Breakeven at 30%-50%
"We have appropriately brought down our operating costs by over $7 billion on an annualized basis, and we've reduced capital expenditures by more than $5 billion over the next 18 months... We have secured over $10 billion of additional liquidity to withstand another full year in a zero revenue scenario.

The breakeven point in terms of occupancy for cash flow generation at the ship level is probably somewhere in the 30% to 50% range, depending on the size of the ship...to have a cash flow breakeven... The number is about 15 ships. The top 15 ships probably generate about 30%, 31% of our cash flow... If I have to account for the fact that... the rest of the ships would be in pause status, [maybe we would have to] operate 25 [ships] to generate a little over 40% of our cash flow." (Then goes on to imply that this is even a conservative estimate)"

Thomas J. Lee, CFA
inquiry@fsinsight.com

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