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# Global Portfolio Strategy

## THINKING ABOUT A NON-APOCALYPTIC FUTURE – TEN 2H20 SURPRISES

## *EXECUTIVE SUMMARY*

In our view, there is too much pessimism by investors and talk of doomsday outcomes and apocalyptic forecasts. We think investors should start preparing for better times ahead.

Stay alert and be ready to shift from macro, technicals, and other tools, back to earnings revisions to help add alpha to your portfolio.

## *KEY POINTS*

- **Key aggressive tactical indicators flashed buy last Friday (Publication Link) after positively inflecting from extreme negative readings…**
- **…Which historically suggests a high likelihood that a tactical trading bottom was in place that would tend to last only 1-4 weeks and fail.**
- **Our research suggests that it's unlikely that all the selling pressure is over, and that volatility will begin to head back down to much lower levels. However, it is our view that the likelihood of significant lower lows for the S&P 500 has greatly diminished.**
- **Investors need to really be focusing on how they should be positioned for what we expect will be a significant improvement in equity performance for the remainder of the year.**
- **In thinking about a future that is not apocalyptic, we are including a list of Ten 2H20 Surprises.**

| | |
|---|---|
| Cons Discretionary<br>Technology<br>Comm Services<br>Financials | Above Benchmark |
| Industrials<br>Health Care<br>Materials<br>Energy | Neutral |
| Staples<br>Utilities<br>Real Estate | Below Benchmark |

**Please refer to Appendix – Important Disclosures and Analyst Certification**

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**Intro**

In our last two notes, we commented that our earnings revisions based methodology for both Sectors/Sub-industries and individual stocks, would be less useful than usual, and that we would be using our normally less used tools in our arsenal more to help navigate the current crisis situation. Importantly, however, we also made the case that within the next several weeks our traditional earnings revisions indicators will be extremely useful as they were coming out of every bottom over the past two decades. So, stay alert and be ready to shift from macro, technicals, and other tools, back to earnings revisions to help add alpha to your portfolio.

**Comments**

We do not want to completely ignore and downplay the severity and seriousness of the current COVID-19 crisis, but it is our view that there are too many doomsday scenarios and apocalyptic forecasts being communicated by pundits. We find it quite interesting, from a behavioral standpoint, that when we started in the business the bulls were always knocking each other over to be known as the most optimistic forecaster and now it seems to be more mainstream to be uber-bearish. With that being said, governments and health care officials should continue preparing for the worst and take the current crisis seriously (i.e. lockdowns work!!), and people should strictly adhere to these containment efforts. But, **for investors, it is our view to start preparing for better times ahead.**

After speaking with one of the smartest people I know, he reminded me of how so many terrible apocalyptic outcomes have been made over the decades and how many of them have actually occurred. Just since 2000, there have been many and one that vividly stands out is Y2K, which at the time was supposed to be the end of the world. In mid-1999 when the Millennium Bug was causing major anxiety around the globe, I was a junior strategist at Morgan Stanley working with Byron Wien, who was one of my early mentors. As I look back, one thing that always stood out in my mind was him saying, "The way to make clients big money is to be out of consensus, BUT you have to be right".

This, indeed, has been the basis and the underlying goal of my entire process for the last twenty years. In our view, there is too much pessimism amongst investors and forecasters. We have been commenting since February that the COVID-19 crisis would be measured in MONTHS and not quarters, which suggests less than six months, and our view has not changed. Also, we have no changes from last Friday's note (**Publication Link**) **where we stated the following: 1) a tactical bottom was likely in place that would last 1-4 weeks; and, 2) that it would likely fail.**

In fact, our research suggests that it's unlikely that all the selling pressure is over, and that volatility will begin to head back down to much lower levels. However, it is our view that **the likelihood of significant lower lows for the S&P 500 has greatly diminished** and the odds of the index retesting at the recent lows, or higher, has considerably risen. Importantly, the bottoming process has likely begun and investors need to really be focusing on how they should be positioned for what we expect will be a significant improvement in equity performance for the remainder of the year.

In thinking about a future that is not apocalyptic, we are including below a list of 10 Surprises similar to what Byron Wien produces at the beginning of every year, and I am keeping with a same basic ground rules — the list contains out of consensus views that we feel have a better than 50% chance of happening.

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# THINKING ABOUT A NON-APOCALYPTIC FUTURE – TEN 2H20 SURPRISES

## 2H20 Surprises

1) The S&P 500 has seen its price bottom and 10-yr yields have also seen their lows.

2) Peak COVID-19 cases will be reached and widespread lockdowns will be done before May starts.

3) A short-term medical solution comes into focus over the next month while progress made on long-term vaccine is still in the works.

4) 2Q20 GDP and corporate profits are both bad, a sequential annualized decline of 5-15% and a yr/yr contraction of 25-50%, respectively, but 2H20 sees the beginning of a V-shaped economic recovery that leads to 4Q20 profits posting positive yr/yr growth.

5) The S&P 500 reaches an all-time high before the year ends.

6) The equity market rally is led by offense, a mix of cyclicals, financials, and secular growth…

7) …While the laggards are traditional defense areas including Utilities, Real Estate, and legacy Telcos.

8) 10-yr yields move back over 1% and head towards pre-crisis range of 1.5-2.0%.

9) The U.S. greenback, on a DXY basis, falls below 100 and settles in a range of 96-99.

10) And before 2020 ends, early rumblings about rising inflation expectations during 2021 and chatter about when the Fed will to start to take back their emergency policy responses.

## Bonus Surprise

For those of you are wondering about a potential second COVID-19 wave that may come and the likelihood of a L or U-shaped recovery, our working assumption is that a medical solution becomes available that preempts it before it begins. Indeed, under this scenario, the impact would likely be small or nonexistent relative to what's going on during the current wave. Consequently, the comparison with the Spanish Flu second wave is less likely to occur in our view and that the bearish implications will not play out.

## Conclusions

- Despite the continued volatility in equity markets and the absence of a medium-term buy signal from our key directional indicators, we are retaining our medium-term bullish view and will view any future weakness as possibly that last opportunity for investors. Our research and view of the macro landscape continues to suggest that investors overly positioning towards defense will ultimately miss a powerful reversal that will prove challenging to forecast in advance. Therefore, we reiterate our offensive positioning with a 6-12month outlook.

- Critically, we continue to strongly advise investors to keep looking for attractive entry points to add exposures into the areas we like instead of trying to pinpoint THE bottom.

- **From an aggressive tactical perspective, our key short-term indicators flashed a buy signal on 3/20 from some of the worst readings we have in our database, which suggested a tactical bounce was likely to begin (see page 3) …**

- …However, our medium-term work (see page 4 and 5) is still falling, which strongly suggests that the current rally is likely countertrend and will ultimately fail after 1-4 weeks. Importantly, this leads to the final process and setting up THE bottom.

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## *DIVING DEEP INTO THE TACTICAL OUTLOOK* **

When diving deep into the S&P500 by using our highest-frequency and most aggressive tactical tools — V-squared (orange line top chart) and HALO-2 (purple line bottom chart) – they both have positively inflected after reaching historical negative extremes on 3/20/20, which was a tactical buy signal that we wrote about in our last note. This signal has led to a powerful and still ongoing rally in the index, but our research still portends that there is a high likelihood that it will only last 1-4 weeks and fail. It should be noted that the expected down move and subsequent bottom will likely sync up with our standard HALO indicator (see page 4 and 5), which would be a powerful signal that THE bottom was in place.


*Source: Fundstrat Global Advisors and Bloomberg*

** NOTES – The proprietary Fundstrat Portfolio Strategy V-squared indicator shown in the top chart (orange line) shows the ratio of VXV (the 3-month CBOE S&P 500 Volatility Index) and the VIX (the 1-month CBOE S&P 500 Volatility Index). This tool is also useful for identifying aggressive tactical trading bottoms for the S&P 500.

The proprietary Fundstrat Portfolio Strategy HALO-2 Model, which is the purple line in the lower chart shown above, is the raw tactical data behind our standard HALO multi-factor model described on the previous page. It is useful for identifying aggressive tactical trading bottoms for the S&P 500.

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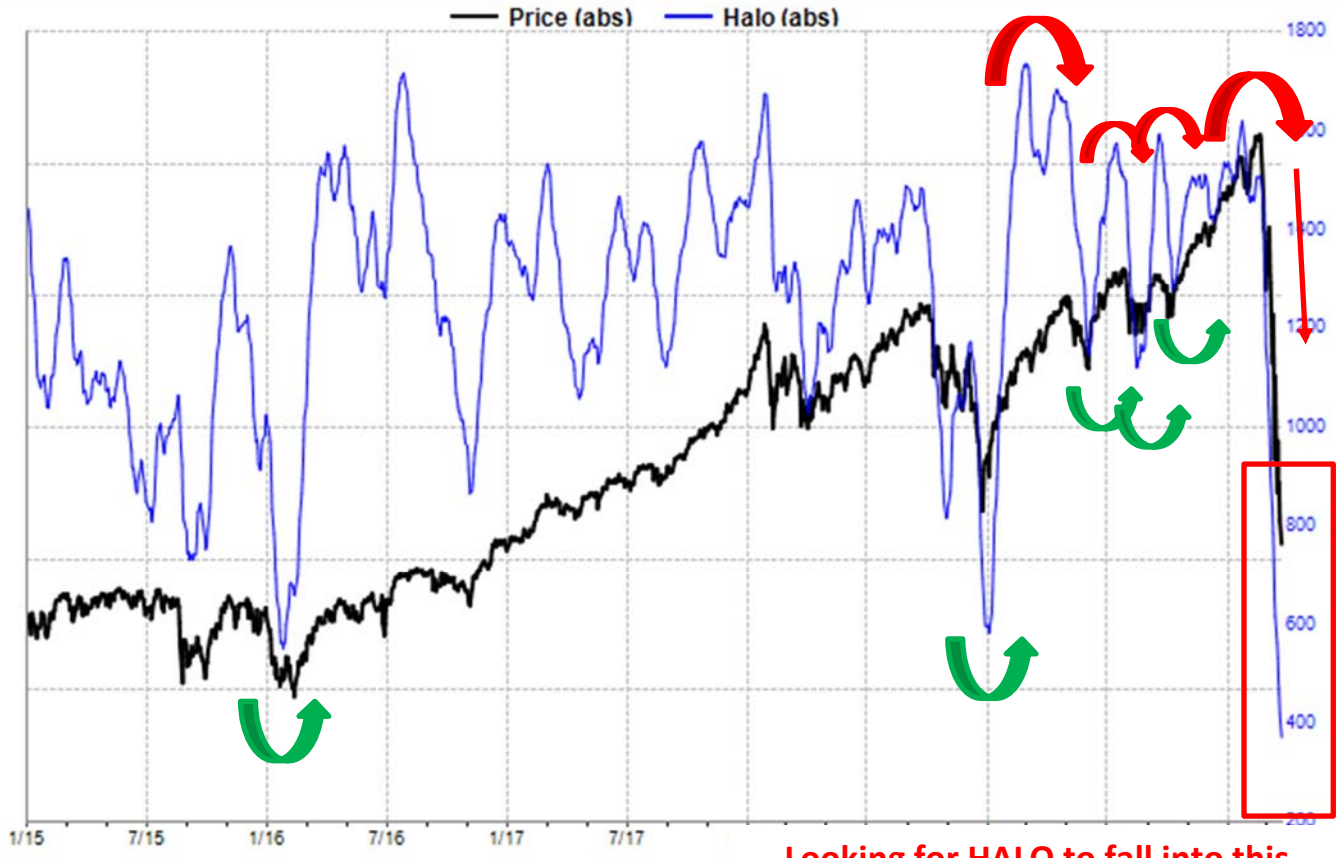
## *S&P 500 TACTICAL OVERVIEW — HALO **

Our preferred tactical model (HALO, blue line below) for the index provided four tactical buy signals since 4Q18 and three short-term cautious/sell signals, which all ended up being quite prescient. Thus, the model continues to be value-added and remains relevant. The model flashed its most recent caution/sell signal on February 20th and is still falling, which is suggesting a **sustainable bottom** is not yet in place and that the likelihood of further downside remains high. With that being said, we will be looking for HALO to bottom likely within the red box highlighted in chart below and to have a positive inflection to once again realign our tactical view with our ongoing constructive medium-term outlook for the S&P 500.

**&P 500 GICS Level 1 - Sectors**

**S&P 500 Index**




**Looking for HALO to fall into this range before next tactical buy signal**

*Source: Fundstrat Global Advisors*

* NOTE – The proprietary Fundstrat Portfolio Strategy Halo Model is a multi-factor model that attempts to predict the forward 1 – 6 month relative performance of a group. The goal is to help both strategic accounts better time their implementation strategies that would be consistent with our more strategic conclusions derived by our sector/sub-industry 8-panels as well as our stock specific Estimate Revisions Model (ERM), and to generate tactical ideas for aggressive trading accounts.

The model has both momentum and contrarian characteristics. When the blue line, which is the model, is trending, our proprietary tool is in a momentum phase, and our research shows a high probability that relative performance will mirror the slope of the line. Importantly, because the model is built to oscillate, an extreme reading that inflects strongly suggests that a reversal in the most recent performance trend is likely to occur.

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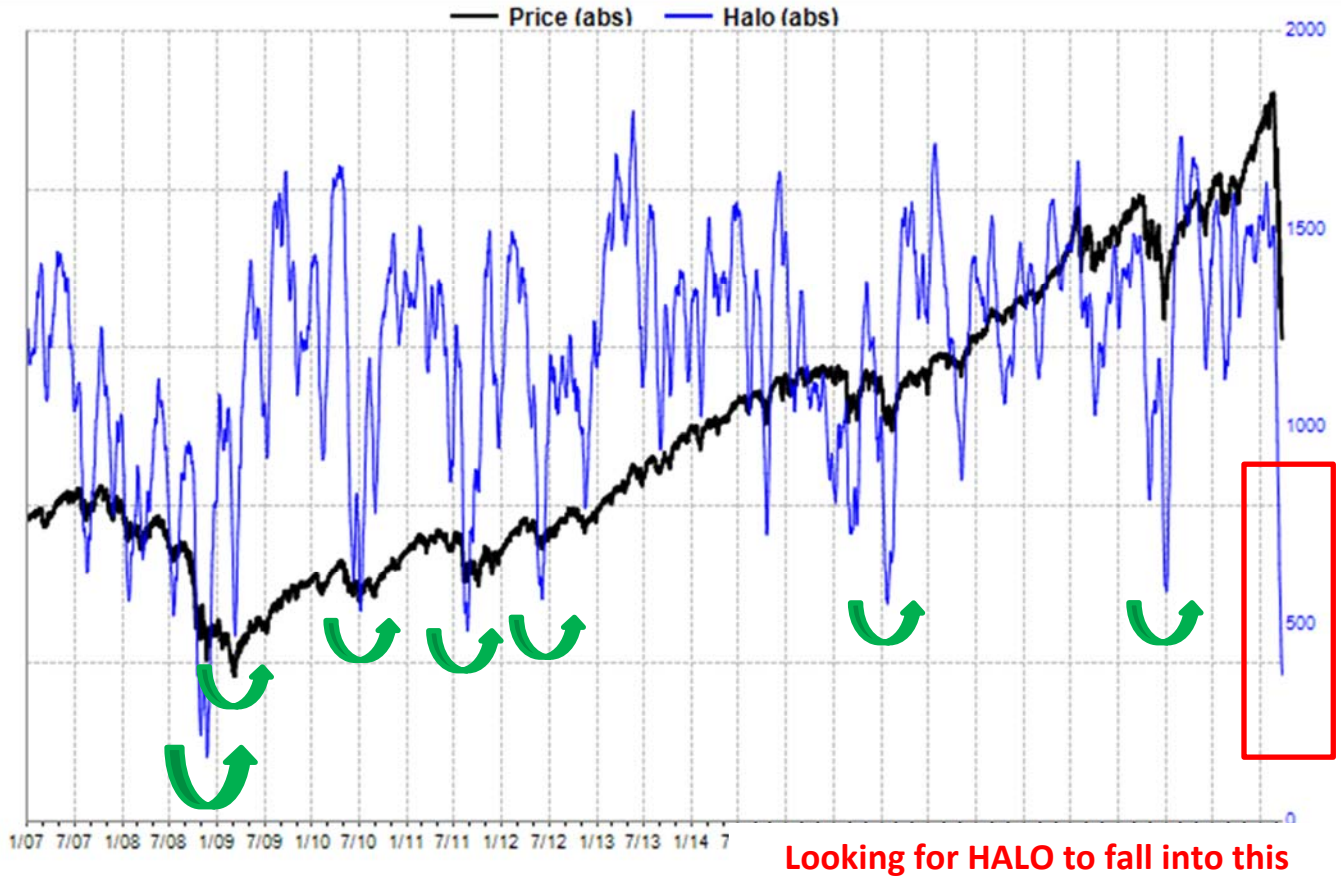
## *S&P 500 TACTICAL OVERVIEW — HALO (LONG-TERM PERSPECTIVE)*

Because the HALO reading (blue line below) is becoming historically extreme, we thought it would be interesting to show a longer-term perspective. Thus, in the chart below, it can clearly be seen that HALO is now quickly approaching the level reached at the bottom of the GFC, which was the worst reading in the history of our database. We would expect to see a positive inflection either before, or at worst coincident, with a **sustainable bottom.** Importantly, contrarian buy signals that occurred below 600 have all provided positive returns for investors when looking forward 6 and 12 months. So, stayed tuned.

**&P 500 GICS Level 1 - Sectors**

**S&P 500 Index**




**Looking for HALO to fall into this range before next tactical buy signal**

*Source: Fundstrat Global Advisors*

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## SECTOR & INTRA-SECTOR IDEAS

| Sectors (GICS L-1) | | Sub-Industry ( GICS L-4 ) | |
|---|---|---|---|
| Name | Recommendation | Favorable | Unfavorable |
| Cons Discretionary | Above Benchmark | Auto Parts & Equip<br>Casinos/Hotels/Cruise Lines<br>Restaurants<br>Apparel, Access, and Luxury | Footwear<br>Automotive Retail<br>Consumer Electronics |
| Technology | Above Benchmark | Application Software<br>Tech Hardware & Peripherals<br>Semis | Electronic Equipment<br>EMS<br>Tech Distributors |
| Communication Services | Above Benchmark | Interactive Home Ent.<br>Movies & Entertainment<br>Interactive Media & Svcs. | Wireless Telecomm<br>Intergrated Telecomm<br>Advertising |
| Financials | Above Benchmark | Diversified Banks<br>Regional Banks<br>Inv. Bank & Brokerage | Insurance Brokers<br>Life & Health Insurance<br>Prop & Casualty Insurance |
| Industrials | Neutral | Capital Goods / Machinery<br>Air Freight & Logistics<br>Human Resourcs | Commercial Printing<br>Office Services<br>Aerospace & Defense |
| Health Care | Neutral | Pharma<br>Life Sciences & Tools<br>Managed Care | HC Technology<br>HC Equip |
| Materials | Neutral | Steel<br>Diversified Metals<br>Metal & Glass | Forest Products<br>Aluminum<br>Construction Materials |
| Energy | Neutral | Exploration & Production<br>Integrated Oil & Gas<br>Equip & Services | Refining & Marketing<br>Storage & Transport |
| Consumer Staples | Below Benchmark | Distillers<br>Ag Products<br>Tobacco | Drug Retail<br>Food Retail<br>Personal Products |
| Utilities | Below Benchmark | Gas<br>Electric | Water<br>Independent Power Prod. |
| Real Estate | Below Benchmark | Hotel & Resort REITs<br>Diversified REITs | Health Care REITs<br>Residential REITs |

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**++**: Fully confirmed earnings revision trend = favorable
**P+**: Red line positive inflection, gray line not confirming yet = aggressive or early warning positive = favorable
**N-** : Red line negative inflection, gray line not confirming yet = aggressive or early warning negative = unfavorable
**--**: Fully confirmed earnings revision trend = unfavorable

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