

Nicolo G. Torre
Ph.D. CFA
Managing Director
Lloyd Tevis Investments

Archan Basu
CFA

3658 Mt. Diablo Blvd
Suite # 201, Lafayette
CA 94549

Market Commentary

April 2021

Pandemic Developments

Globally a surge in COVID-19 cases is underway. Many regions are returning to previous peak case rates or are setting new highs. It's not clear what is driving this surge, but a reasonable concern is the emergence of new strains of the disease.

Approximately 200 variants of the virus are known to science and five variants are known to have evolved either greater contagiousness, greater lethality or moderate resistance to human antibodies. Two of those variants are of importance in the United States (per table below.) Fortunately, no variant has yet combined enhanced contagiousness, lethality and resistance. Nor has any variant proven to be resistant to the existing stock of vaccine. Still, it seems only a matter of time before a more dangerous variant emerges and spreads widely. Continued public health measures therefore remain of paramount importance.

Significant COVID-19 Variants as of March 2021

Category	Variant	Emergence	Global Distribution	% US cases	Transmission	Lethality	Treatment Characteristics
High Consequence	none so classified at this time						
Concern	B.1.1.7	Kent, UK Sept 2020	locally dominant, global spread	9.90%	1.5x higher	likely higher	similar to standard covid
	B.1.351	KwaZulu-Natal, South Africa August 2020	locally dominant, spread globally except S America	0.40%	1.5x higher	possibly higher	moderate resistance to antibodies
	P.1	Manaus, Brazil Dec 2020	very common in Amazonia, spread to N America, Europe & India	0.10%			moderate resistance to antibodies significant resistance to some treatments, moderate antibody resistance
	B.1.427	Los Angeles, July 2020	locally common and spreading in US	4.30%	1.2x higher		significant resistance to some treatments, moderate antibody resistance
	B.1.429	Los Angeles, July 2020	locally dominant and spreading in US	9.80%	1.2x higher		significant resistance to some treatments, moderate antibody resistance
Interest	B.1.526	New York Nov 2020		2.90%	potentially higher		potential antibody resistance
	B.1.525	New York Nov/Dec 2020		0.20%	potentially higher		potential antibody resistance
	P.2	Brazil April 2021		0.80%	potentially higher		potential antibody resistance

Notes: Figures on the percentage of US cases due to the variant are based on sample data from February. A strain determination is made in about 1% of cases. Variant B.1.427 and B.1.429 account for 57% of California cases and 45% of Nevada cases. B.1.1.7 accounts for 13% of Florida cases. The three variants together account for 14% of Texas cases. Variant B.1.1.7 appears to cause more illness in children and young adults than standard covid does. Source: CDC, WHO

Thanks to vigorous interventions by the Biden administration, vaccination is moving apace in the United States. The vaccination rate is approximately 100 million per month and vaccine production no longer seems to be a gating factor for vaccine administration. This is a best-in-world performance – a dramatic turnaround from the United States' previous worst-in-world position for

Covid control. Europe, by contrast, is floundering with its vaccine efforts. They are administering about 23 million doses per month. This is a rate comparable to that achieved by India. The Covax initiative to distribute vaccine to some 60 low-income countries is distributing 32 million doses per month spread across a total population of several billion. Probably because of its high vaccine effort, the United States is experiencing less of a surge in Covid than any other large region.

Public health idiocy, however, has not disappeared from the United States. In Texas, the Governor announced (incorrectly) that Covid was beat and ordered the lifting of most public health measures – notably including mandates to wear a face mask. When the City of Austin sensibly decided to continue mandating mask-wearing, the state Attorney General sued them to obstruct this public safety measure. There is no sound argument here based on civil liberties, economic concerns or medical science; rather, masks remain an evident, effective and proportionate intervention, and a mandate increases public compliance. It is past time for such obstruction to be called out for what it is – an oblique form of mass murder. Unfortunately, Texas' example is being followed by Mississippi and Arkansas, where governors argue they can relax precautions since Covid is currently resurgent in other states, but not theirs. This repeats the faulty reasoning that underlay last summer's Southeast surge: neither MS nor AR yet have sufficient strain surveillance in place for the CDC to determine the prevalence of variants, so once again absence of evidence is being treated as evidence of absence.

A heated battle over voting procedures is also underway. It is generating some truly overheated rhetoric in which (Michigan congressional) colleagues are described as witches who should be burned at the stake or as members of a vast treasonous seditious conspiracy. We doubt that this fuss will have much consequence for investors and so we are largely ignoring it. But we note the overheated partisan atmosphere as an obstacle to rational decision making in other spheres of life. We are hopeful that as the pandemic wanes the public will turn to the serious business of celebrating its survival and that politicians' anguished cries of existential threat will cease to find an audience.

The WHO issued a lengthy report on its investigation of the original Covid outbreak in Wuhan. Their findings were inconclusive but supported the theory that a bat-derived virus worked its way into the food delivery chain. This theory is plausible and indeed, was exactly the plot of the 2011 movie "Contagion." NIH head Dr Fauci accepts this finding. His colleague, Dr Redfern, former head of the CDC, believes instead that the virus originated in a lab accident. This theory also is plausible. Experience with US biosafety level 5 labs has shown that accidents do occur which lead to infections among workers. It is possible that a worker at the Wuhan virology lab became infected, but being asymptomatic the contagion was not recognized and the worker transmitted it to the local food market. A number of biosafety level 5 labs were opened in Asia in the past decade and had been identified as an emergent biorisk prior to the outbreak of the pandemic. Whatever the origin, there is a US consensus that the Chinese were less forthcoming than they might have been and that this reticence materially aided the virus's initial penetration of the world community. European leaders have called for an international treaty to address the threat of pandemics. We are skeptical that such a treaty will accomplish much unless it is linked to trade restrictions on noncompliant states.

The President's Press Conference

President Biden gave his first press conference. Biden is a very known political quantity, yet this conference shed fresh insights into how he views his presidency. Whereas Putin, Xi and Trump all carry profound nostalgia for perceived past periods of national greatness, Biden appears forward-thinking. He described the world as in the midst of a fourth industrial revolution and emphasized the

United States' need to retool to sustain prosperity. Biden's sympathies for the working man are well known, yet seem unlikely to lead to Luddite policies. Biden is the first President from the so-called Silent Generation, who experienced the Great Depression and WWII primarily as stories handed down by parents who had lived them. Biden's cohort became adults at the zenith of America's relative economic and political power but under the atom bomb's shadow. Politically they led the Civil Rights movement, but personally the social turmoil of the 1960s painfully disrupted their family lives more than it liberated or empowered them. All of this imprinted a unique blend of optimism and caution; the cohort prefers operating levers of power to disrupting them. Certainly Biden's personal style is notably quieter than any president since Coolidge. Asked about China, he reminded us that he knew President Xi well. He described China's leader as a very bright autocrat determined to make his country into the world's leading economic and military power – but then added “not on my watch.” Presidents Roosevelt and Truman made a somewhat bigger deal of their determination to thwart the ambitions of the various autocrats they faced. Biden comes to power in his full political and personal maturity, as did Eisenhower and Reagan; all three stepped in knowing what they wanted to accomplish and with ideas on how. Should Biden's presidency continue their arc, we can expect a vigorous first term – with eventual health issues possibly slowing down a second term.

Budget Priorities

Biden's quiet words will need to be coupled with a big stick if he is to carry through on his determination to balance China. Immediately he faces a naval race in the Western Pacific. An appropriate response would be to stand up two additional aircraft carrier groups and a dozen attack submarines – a total cost of about \$50 Bn. It seems the groundwork is being laid for a navy budget expansion of \$5 Bn this year – a down payment on what is called for. Military aviation is absorbing a technical revolution in the form of unmanned and semi-autonomous aircraft; how this should be reflected in naval airpower is not yet worked out. As strategic thinking clarifies, we expect budget commitments to increase. The naval end of the defense industry could see sustained prosperity for a decade or more.

For now, media is focused on Biden's infrastructure bill – a proposal to spend \$3 T over a decade on a huge array of infrastructure projects, at least partially funded with increases in corporate and personal income taxes. As usual legislators are incentivized to engage so as to draw Federal spending to their districts and protect constituents from the taxman. Republicans may hold aloof as Democrats force through a bill narrowly tailored to their interests. Or Republicans may engage and strike a grand bargain – allowing some of the Democrats' wider reform agenda to move forward in return for some Republican influence over the money bill. With the Covid relief bill Biden felt an urgency to act, and was content to cram the bill past united Republican opposition; with infrastructure he appears willing to try politicking first. We are confident that a large spending bill coupled with a moderate tax rise will eventually emerge, and that fiscal economic stimulus will continue for years. Perhaps that will finally provide the Federal Reserve room to wind down its crisis interventions and revert toward a more traditional monetary policy.

Market Overview

Having opened the year with multiple cyclical upswings – in business cycle, vaccine distribution, and government stimulus – we saw strong equity returns in the first quarter. It's an old truism that stocks follow earnings; not only are earnings now expected to grow at double-digit rates through at least the third quarter, but those rates have gotten repeatedly revised upward. Accelerating vaccine rollout clearly helped; currently we're inoculating 1% of Americans per day. And markets now have

the long-awaited infrastructure bill (though so far not the accompanying tax changes) firmly within sight. This confluence of circumstances gave a strong boost to US equities, pushing their index levels decisively past those tentative peaks of mid-January and mid-February toward new records.

Market Index	March 2021	Jan - Mar '21
S&P 500	+4.4%	+6.2%
Russell 2000	+1.0%	+12.7%
MSCI EAFE	+2.3%	+3.6%
MSCI EM	-1.5%	+2.3%
Bloomberg Barclays US Aggregate Government	-1.5%	-4.3%
Bloomberg Barclays US Aggregate	-1.2%	-3.4%
Bloomberg Barclays US High Yield	+0.2%	+0.9%
BofA/Merrill Lynch European High Yield	+0.6%	+1.5%
JPM EMBIG	-1.1%	-4.8%

Those index peaks were attained despite sell-offs in many previously high-flying growthy tech names like Apple, Netflix, Nvidia and Tesla. Indeed, we've now seen several months where technology, along with consumer and healthcare sectors, cooled off while the cyclical-value sectors of energy, financials and industrials carried the torch. This rotational trend could continue, as those cyclicals still remain relatively cheaper, and will also benefit from economic reopening and planned investments. Being always skeptical of consensus, we had wondered some months ago whether this view was already too widely held to actually work; it's a useful lesson that some investment ideas flourish even after all the experts agree that they should!

The 10-year US treasury yield is up around 0.8% so far this year, ending the quarter at 1.74%. This rise is directionally consistent both with the improved economy (unemployment now down to 6% while inflation ticked up to +1.7%) and with widespread concern that inflation may further rise. That concern will remain in focus whenever Fed Chairman Powell or Treasury Secretary Yellen are seen on CNBC; for now, they appear so consistently calm, coordinated and in control that market fears may subside – in which case, we may already have seen the year's largest move in market yields. Either way, it's not too late for borrowers to refinance that mortgage, nor need you urgently rush to do so. Conversely for lenders and investors, the losses you've experienced so far this year (-3.4% on the Barclays Agg) are modest enough not to cause much harm, and do not negate the usefulness of those holdings going forward. Remember: you'll make up a good portion of the loss via income over the balance of the year (and for those technically inclined: roll return too is prospectively higher given recent curve steepening); besides, should equities sell off sharply along the way, you've got valuable ballast to help cushion portfolio losses.

Emerging market assets were favored by many (including us) but so far this year they've underperformed. China has maintained strong economic indicators, though others faltered, and China's own tech stars (like Alibaba, Baidu and Tencent) sold off along with their US peers. A stronger US Dollar is one obvious driver of these weaker emerging market returns. Dollar strength in turn follows from those rising 10-year Treasury yields, plus some perceived relaxing of Washington's tone (if not yet policies) on trade. But emerging markets remain poised to benefit from US expansion and stimulus, and their prices and demographics remain relatively attractive – so on balance, we maintain a positive view on emerging equities, particularly in value sectors.

Our biggest recent miss was in Bitcoin, which we ironically dismissed just last month as “largely institutionally untested” even as BNY Mellon, Visa, and Fidelity ramped up their adoption. Tokens are up +20% last month and over +100% over the past quarter to \$58,800. Having now studied the original paper by the pseudonymous Satoshi Nakamura and considered current implications, our enthusiasm has grown, and we are inclined to accumulate a modest position on pullbacks. JP Morgan recently raised their price target to \$130,000, the level at which all holdings in the cryptocurrency would equate to “total private sector investment in gold” – that shiny metal to which Powell recently suggested it is a reasonable alternative (and not to the dollar).

Two other events in March caused investor concern that then dissipated quickly. First, former hedge fund star Bill Hwang's deep losses in leveraged stock positions (held via total return swaps) forced a disorderly \$20 Bn liquidation that also hurt his counterparties Credit Suisse and Nomura, and raised concerns around regulation of opaque family offices. Second, an accidental 7-day blockage of the Suez Canal with resulting shipping backlog raised fears of unwanted cost overruns, oil shortages in Europe, and economic slowdown. Thankfully none of that materialized; it helped that with the global economy still operating below peak capacity, stocks remains ample, so transport blockages needn't cause price spikes. Since neither of these incidents grew beyond their initial scope, investors instead coalesced around a narrative of evident market resilience. Clearing such tests also helped the volatility index VIX to settle at quarter-end to the fairly reassuring level of 19, its calmest since February '20 and a meaningful drop from 27 a month earlier.

Outlook & Guidance

'Punctuated equilibrium' describes how markets behave, and for now, things do appear calm. Reopening and vaccination will bring forth continued good economic news as, by now, markets surely fully anticipate. Indeed, from the perspective of markets, the coming months appear relatively uneventful: watch for media to shift domestic focus from charged topics like politics and pandemic toward more granular debates around likely post-pandemic patterns of living, work and leisure.

We previously pointed out the risk of an apparent bubble centered on FAANG stocks; at this point a little air has escaped (due to a few price declines, coupled with healthy earnings growth all around) making catastrophic implosion feel less imminent. It pays to bear in mind that bubbles can suddenly burst or can continue to inflate seemingly without end. Note the ISM PMI (Institute of Supply Managers' Purchasing Managers Index), an oft-cited barometer of corporate sentiment, was just reported at 64.7%, well above expert forecasts of 61.3% and indeed its highest reading since 1983. ISM readings above 60% have been reliable contrarian indicators of impending market decline over subsequent months.

Overall, moments like this are best used to book some gains in positions that are now overweight, while tuning up plans and portfolios for the longer term.

THIS IS NOT INVESTMENT ADVICE, WHICH INTER ALIA, WOULD BEGIN WITH AN EXPLICIT REVIEW OF YOUR CIRCUMSTANCES. ALSO NOTE THERE ARE NO SPECIFIC BUY OR SELL RECOMMENDATIONS HEREIN. PAST PERFORMANCE IS NO GUARANTEE OF FUTURE RESULTS. DATA CITED IS SOURCED FROM 3rd PARTIES AND BELIEVED ACCURATE.