Summit Global Investments

April 21, 2020

It has only been two weeks since my last letter and it feels like it has been a few months. In my earlier letters, I compared the stock market to a baseball game and explained how we are only in the first few innings. Clearly, we have now entered the middle innings, e.g., the 5th and I can't wait to get through this game.

The market thought, after rallying nearly 25% off the lows, it was going to continue; to eclipse all-time highs set in February (highs that took years to reach); to trade solely on liquidity measures provided by the Fed and Treasury. But such would not be normal, normalcy would require the market to trade on fundamentals. The White Knight has not come, so we wait for more normalcy, which seems to have arrived. As they say, seeing is believing. We all knew the economics of COVID-19 would be terrible, and they have been!

This past week, like a broken record, we saw big trades into very speculative companies and industries, e.g., airlines, autos and energy. SGI believe such risk is unwarranted and has more downside risk than upside potential. These companies, though some have 'heaved' out a stellar performance so far in April, all have zero demand to stand on. If you fly today, you will fly private. If you drive today, you will not have a traffic jam. Breathe the air – it's so clean! We do not recommend such speculation.

We have had several calls about our thoughts on oil. In short, I'd rather miss out on those 20% returns over the past few weeks from oil than lose much more in a few days. We recommend continuing a defensive positioning through SGI's managed risk approach. We see the U.S. equity markets continuing its schizophrenic mannerisms. We continue to see headwinds (see my previous letters for details) putting immense pressure on the market to trade back to fundamentals.

As an investment manager we will continue to trust and follow our investment processes. We hope this helps provide a more direct connection with the investment team and be informative and useful. For questions please do not hesitate to reach out to our team through our website, www.sgiam.com, phone, 888-251-4847, or email.

Sincerely,

David Harden

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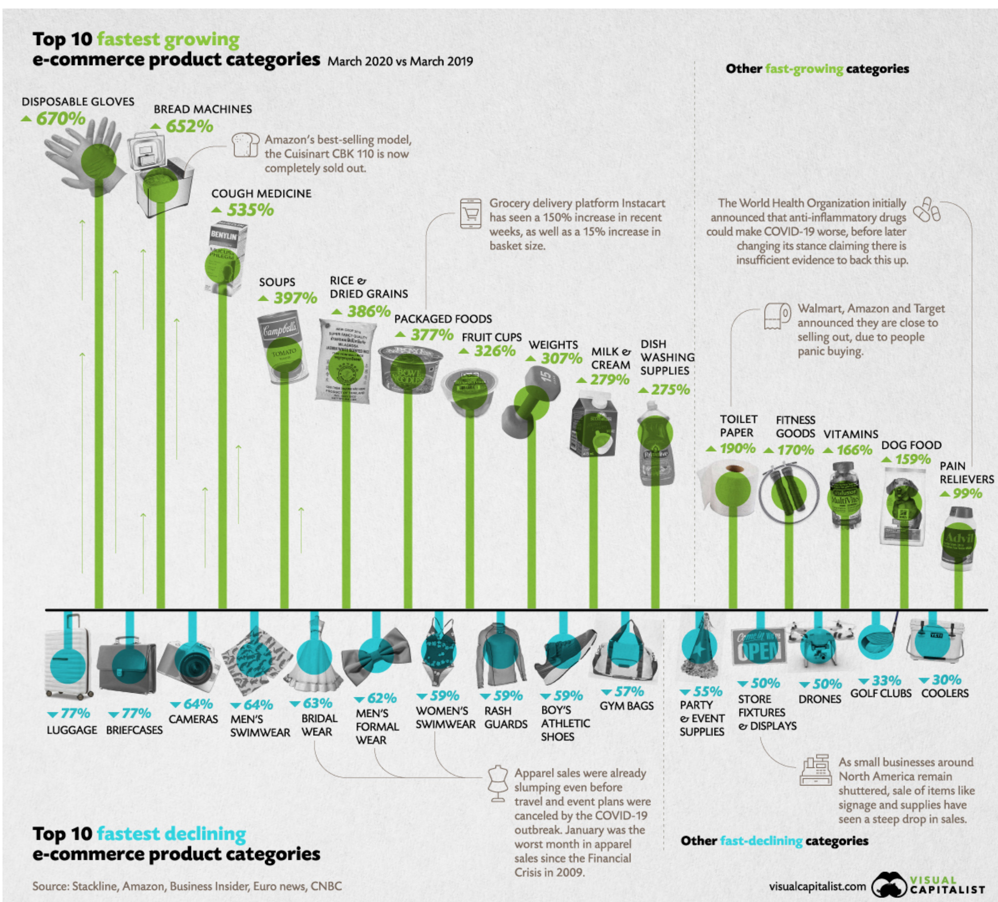
Established in 2010, Summit Global Investments (SGI) is a specialized asset management firm. SGI utilizes a quantitative process to analyze the market and select the best possible stocks with the least amount of adverse surprises. We further incorporate fundamental analysis to examine for idiosyncratic downside risks, while considering ESG characteristics. In short, we refer to this is as a "managed risk approach". One that is dynamic enough to adjust in different styles, e.g., a growth or value market and in different risks, e.g., a bull or bear market. SGI's managed risk approach has won multiple awards both in 2019 & 2020.

Market Update:

Active Management and Winners and Losers:

Normally there emerges new winners and losers from a crisis as people's spending moves companies profit margins and growth trajectories. I have been saying, since January, that the story of Clorox has changed. Recently I was a guest on CNBC's Exchange program with Kelly Evans where we discussed Clorox. (https://sgiam.com/our-insights/#media - click on the CNBC icon) If I could find some Clorox I would send it to her and the producer to say thanks – but Americans are buying it off the shelfs before the shelf can be restocked.



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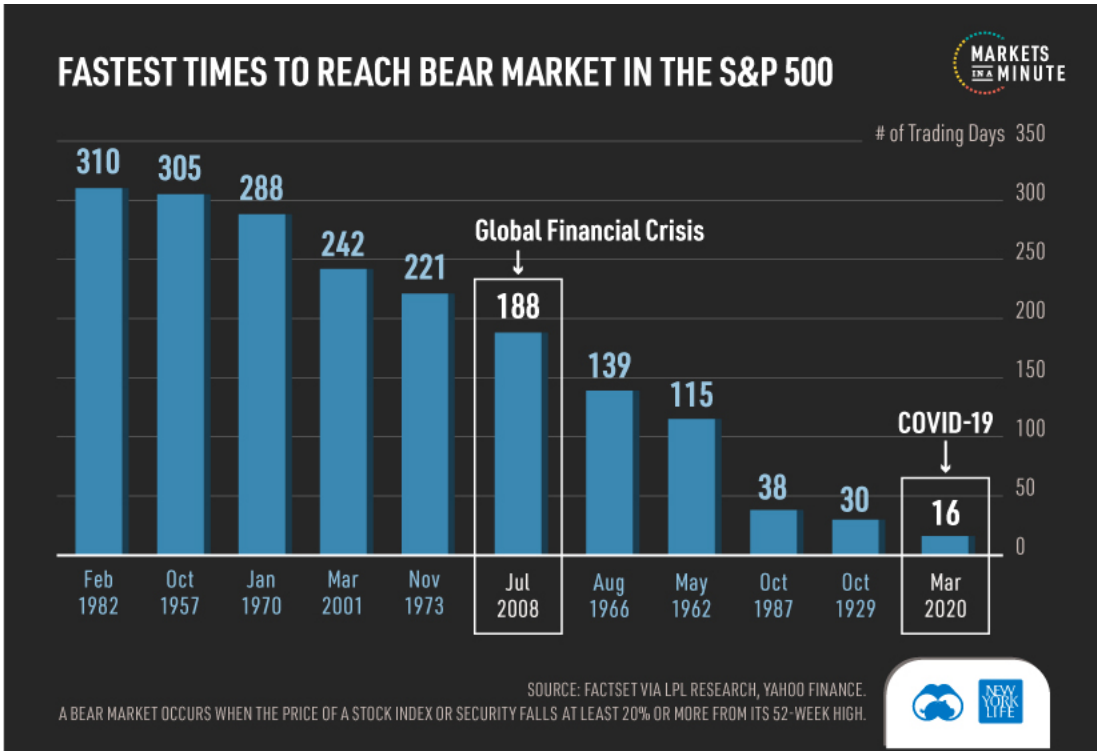
Tail risk off the table (for now):

We still believe the Federal Reserve has taken a negative tail risk (think avoiding a Great Depression) off the table. This is one reason the market bounced off the lows so quickly. The other reason for the bounce may be traders noticing how fast and steep the market fell.



The stimulus and unprecedented actions of the Fed have gone from 2008 supporting those who were deemed “Too big to fail” to “No one will fail”. One problem with supporting every company and industry is the short-term liquidity may not support long-term benefits. Normally I would be very bullish when global central banks expand their balance sheets to support asset prices. My sense is the most recent run-up, much more than the historical descent, is being driven by the Fed creating liquidity.

Though the Federal Reserve’s liquidity actions are well intended, they may create serious side effects. The stimulus package(s) are easy to like yet they may become even easier to criticize. It’s easy to see how the US is heading down the path of massive deficits and monetizing them over time. This, as Japan can attest, does not lead to higher economic growth over time.

A very important question is what will the Fed do next? There is little doubt the Fed will remain very proactive. The question remains how risky will they go and is it focused on the right solution? Though stimulus has supported several industries and companies – who will be next? Did you say Oil?

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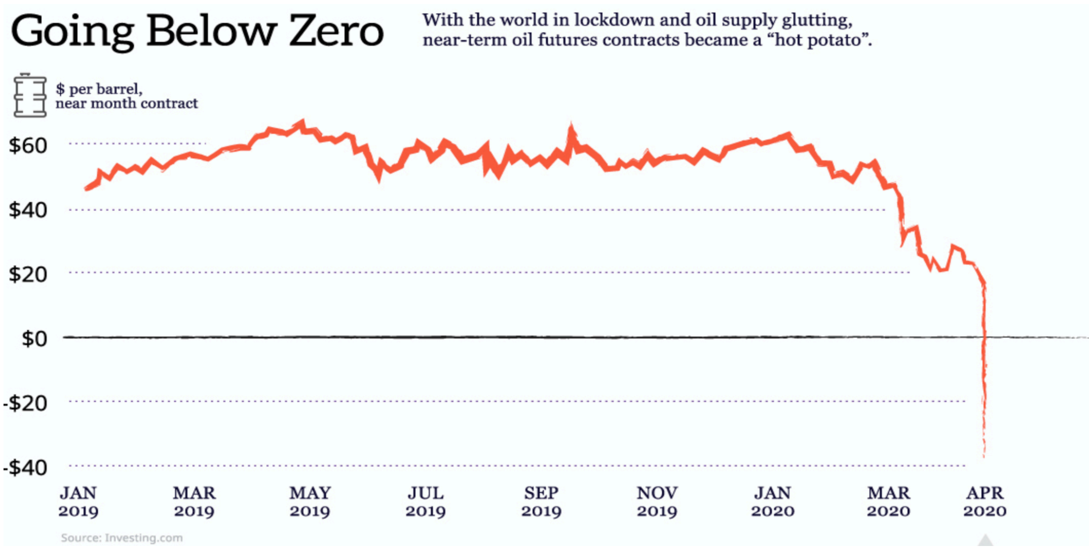
<u>Oil!</u>



Oil is in free fall. It is in contango. It seems I have explained contango more in the past week than the past ten years combined. Many believe that since oil prices in June, July and further out looked normal that buying at such a low price now makes sense.

The reality of contango is when the price of futures is higher than the current spot price. In other words you have to pay more in the future for an item you may purchase today for less. The best-case scenario for traders during contango is buying the physical oil now and waiting for the future price to increase, once lockdowns come to an end. However, the problem is in March it was estimated that 76% of the world's available oil storage was already full. A record amount of oil is being stored on massive tankers at sea and at Cushing, Oklahoma. The cost to store oil, according to Rystad Energy, has exploded from $20k/day for an oil supertanker in February to over $200k - $300k/day today.

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COVID-19 and Healthcare Issues:

Since the market has reacted so violently to the fear of COVID-19 and the shutting down of cities across America, then perhaps Powell & Co. may look to spend money on beating the virus. Isn't, at the end of it all, COVID-19 the actual enemy? Maybe working on the healthcare system of America will create more jobs and less fear than supporting anything else? During the Great Depression, and ever so close during the Great Financial Crisis (GFC), there was a run on banks. Today, nothing. Banks are fine, the Fed has fixed this potential problem with liquidity. However, we are experiencing a run on the U.S. healthcare system. Recently, I visited with a nurse who has been forced to use the same mask for an entire week. Seriously! Where can I get masks to give her a year supply (my family is currently sewing masks)! We need to fix this problem! The Federal Reserve, with all the capabilities of money supply, needs to help fix this problem. We must solve the run on PPEs, masks, ventilators, etc. If we fix the run on healthcare, we may ultimately end up fixing our economy faster. The chart below shows how the U.S. has 4x as many cases as the next highest country. Let's hope this is due to the fact the U.S. is testing 4x as much. Only having 4.3% of the world population, yet having 25% of all confirmed COVID-19 cases and deaths worldwide is a massive delta.

Country Summary – Top 12 by Total Cases

Country	CASES					DEATHS				
	Total Cases	Total % Pop	Cases 1 Day	Cases 5D Avg	Daily Peak	Total Deaths	Total % Pop	Deaths 1 Day	Deaths 5 Day Avg	Daily Peak
US	784,326	0.2389%	25,240	29,443	33,755	42,094	0.0128%	1,433	2,711	4,591
Spain	200,210	0.4282%	1,536	4,612	9,630	20,852	0.0446%	399	466	961
Italy	181,228	0.3002%	2,256	3,123	6,557	24,114	0.0400%	454	508	919
France	156,480	0.2397%	2,383	4,187	26,849	20,292	0.0311%	548	757	1,440
Germany	147,065	0.1755%	1,881	2,618	6,933	4,862	0.0058%	276	261	510
United Kingdom	125,856	0.1854%	4,684	5,169	8,733	16,550	0.0244%	455	737	981
Turkey	90,980	0.1079%	4,674	4,312	5,138	2,140	0.0025%	123	123	127
China	83,817	0.0058%	12	85	15,136	4,636	0.0003%	0	215	1,290
Iran	83,505	0.0994%	1,294	1,438	3,186	5,209	0.0062%	91	88	158
Russia	47,121	0.0323%	4,268	4,337	6,060	405	0.0003%	44	39	48
Brazil	40,743	0.0192%	2,089	2,580	3,257	2,587	0.0012%	125	176	217
Belgium	39,983	0.3450%	1,487	1,477	2,454	5,828	0.0503%	145	279	496

Sources: Wolfe Research Portfolio Strategy, CDC, JHU CSSE, The COVID Tracking Project, WHO and Bloomberg.

And though there is a possibility of additional "Hot Spots", let's hope that these subside quickly.

U.S. Counties with >100 Cases, Sorted by Biggest % Increase Over the Past Five Days

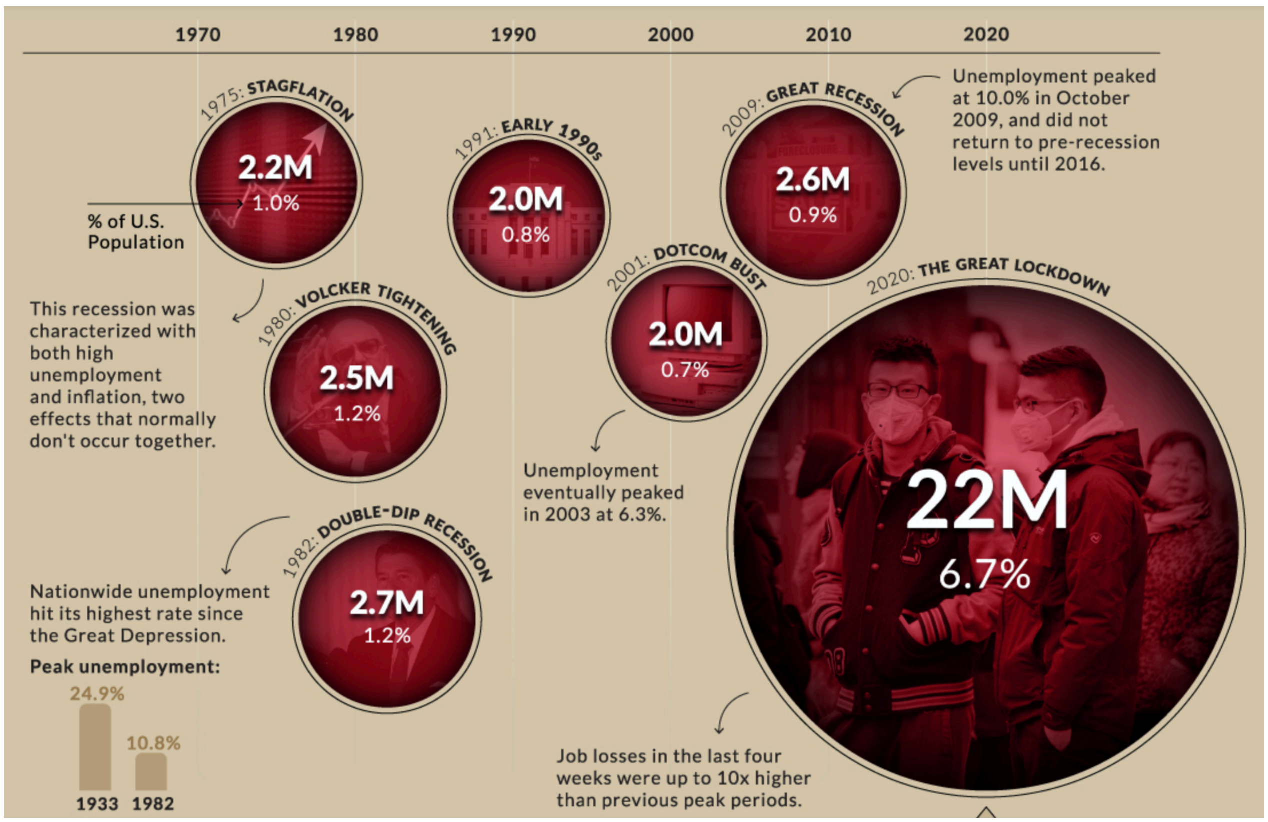
State	County	Cases			Deaths		
		Total	Increase (#, 5 Days)	Increase (%, 5 Days)	Total	Increase (#, 5 Days)	Increase (%, 5 Days)
Ohio	Marion	1,834	1,724	**1567%**	1	1	NA
North Dakota	Grand Forks	133	121	**1008%**	0	0	NA
Kansas	Ford	127	109	**606%**	0	0	NA
North Carolina	Wayne	463	385	**494%**	4	2	100%
Nebraska	Dawson	124	103	**490%**	0	0	NA
Ohio	Pickaway	477	380	**392%**	4	4	NA
Indiana	LaPorte	140	104	**289%**	5	2	67%
Iowa	Marshall	155	113	**269%**	0	0	NA
Texas	Moore	106	70	**194%**	0	0	NA
Virginia	Harrisonburg city	236	141	**148%**	0	0	NA

Notes: U.S. county data is one day lagged, data through 4/19/2020.
Sources: Wolfe Research Portfolio Strategy, CDC, JHU CSSE, The COVID Tracking Project, WHO and Bloomberg.

Unemployment:

With such numbers it seems very unlikely that the U.S. economy will simply “open for business”. But rather, a more choppy and gradual opening. I have likened the economy to a muscle that with limited use or exercise will atrophy which takes significant time to recover back to full strength.

What does atrophy look like for our economy? Since March 1st the US has lost more jobs than all the jobs created since the GFC (10+ years ago). In October 2009, unemployment peaked at 10% and totaled 2.6M. Employment did not return to pre-recessionary levels until 2016.



By this coming Thursday, 4/23/2020, the US will have more unemployed than the entire population of Australia!

White Knight – We are still waiting….

Fortunately, there is always and remains hope. Numerous companies are working diligently on solutions with some beginning to see positive results. We hope to see the White Knight. Yet the longer the market faces COVID-19 the longer it will take to rebuild the U.S. economic muscle. We believe we will see more normalcy return to the market – though this may be more downside as it returns to fundamentals, it also would mean greater upside in the long-run.