Stouff Capital

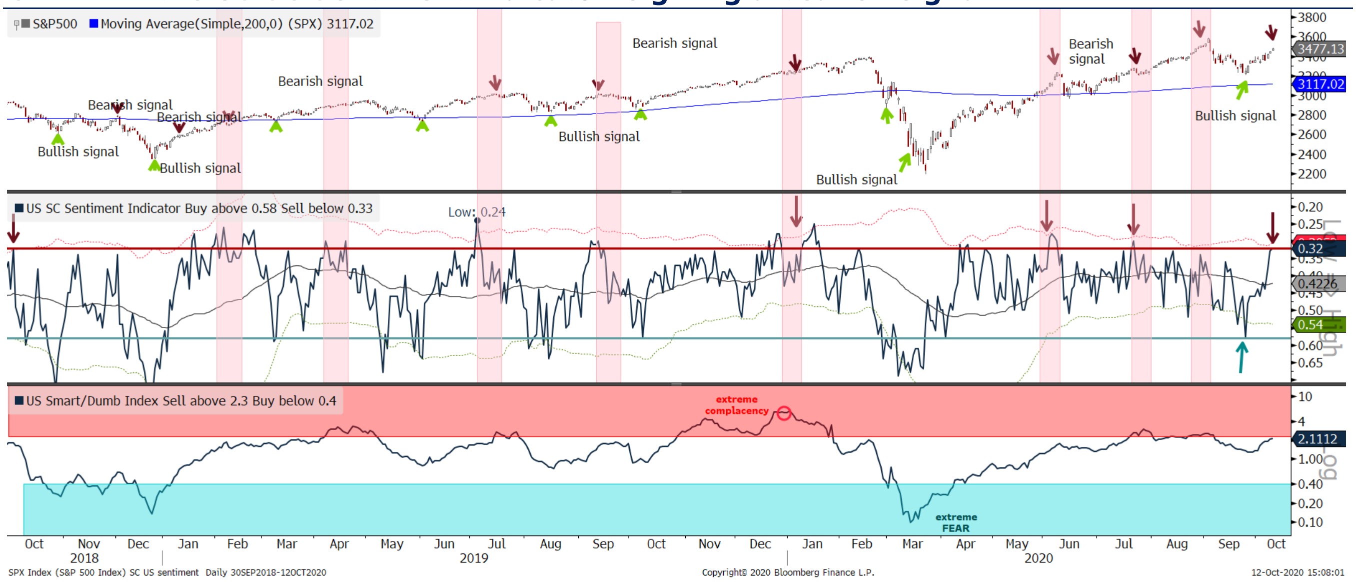
Global Equity Long-Short Quantamental Strategy

update as of October 12th, 2020 | Letter 50

THE BLUE WAVE AND THE SECOND WAVE

Global equities have nearly retraced their September correction while our SC US sentiment indicator is currently giving a short-term bearish signal (Chart 1). Behind the incessant political noise, the Blue wave scenario (Biden president with a Democrat sweep in the senate) is rising in the polls and betting odds, and is finally considered as a tailwind for equities as it implies a significative fiscal stimulus at a time when the Covid19 second wave is evolving. **US markets are not currently afraid by a Democrat Blue wave; while the rest of the world's equities are benefitting from the blue wave trend as it is bearish dollar. Europe must nevertheless cope with a second Covid-19 wave and the Brexit saga**. All in all, we expect a year-end rally with a 10 upside (S&P500 between 3600 and 3750) but expect a pause until the outcome of the US election and a fast correction if the US elections are delayed.

CHART 1: the US SC Sentiment indicator is giving a bearish signal

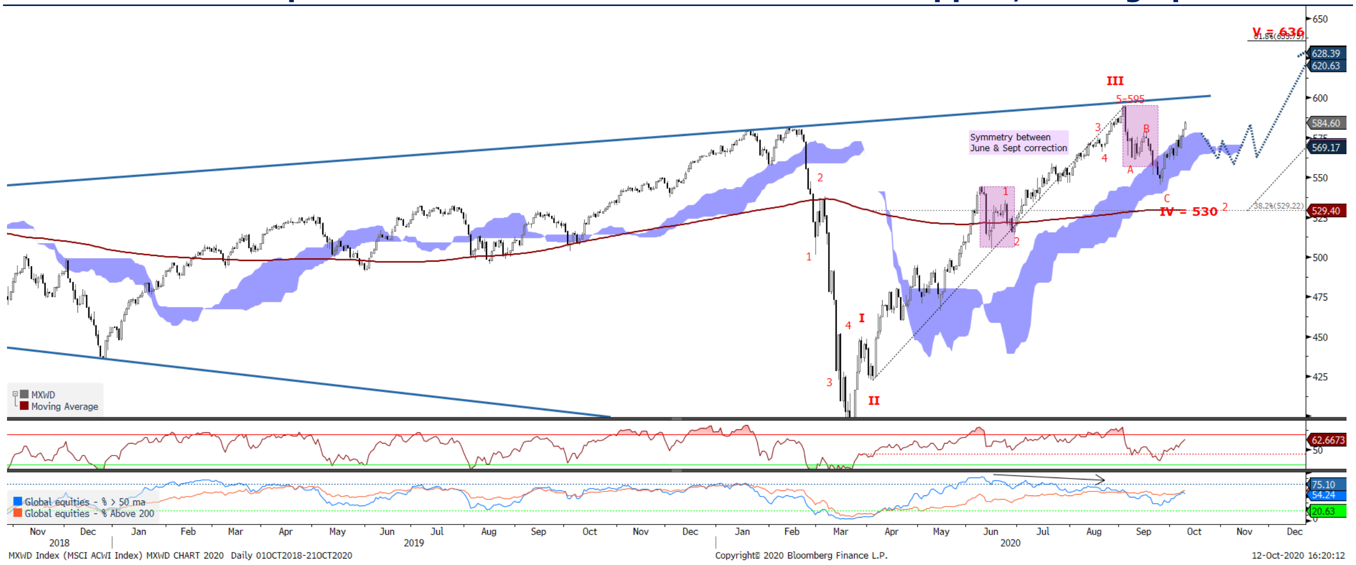


Source: Bloomberg – Stouff Capital

Global equities (MSCI World in chart 2) have rebounded on our wave IV target on September 23rd and nearly retraced their September drawdown. Our matrix had switched back to bullish and we expect a technical wave V target for 4Q (3,692 for the S&P500, 636 for the MSCI World, 13765 for the Nasdaq, 13,866 for the DAX).

However, it is too fast in price and time just before a lot of catalysts. Falling implied volatility (specifically on the Nasdaq) offers an opportunity to add the cheapest convexity level since the start of the summer to cope with a possible consolidation phase until the US election. Then depending on the outcome, we have 3 scenarii: (1) a step higher to 3,690 if the US election is not delayed and brings a pro market outcome (Biden or Trump with a split congress), with central banks still very accommodative (target is increased to 4,000 if a vaccine comes before the end of the year), (2) a Blue wave scenario with a first sell-off between 3,100 and 3,350 depending on the characteristics of this win (should be not too progressive for the market), followed by a multi-months rebound first to 3,692 then to 3,915 in May 2021 – This is our favoured scenario (3) a return to extreme volatility owing to a delay of the election in a second wave Covid-19 environment (target range 2880-3150).

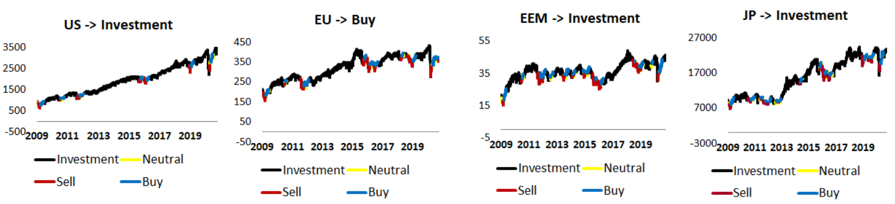
CHART 2: Global equities have rebounded on their wave IV support, moving up to wave V



What our Matrix tells

EQUITY REGIONAL GRADES, GLOBAL EQUITIES MATRIX 12.10.20

EQUITY REGIONAL GRADES		100%	from 10 to 30%	from -25% to -10%	from 10 to 30%	from 10 to 30%
Three month outlook Bullish	11%		Bullish	Bearish	Bullish	Bullish
One month outlook Bullish	22%		Bullish	Bullish	Bullish	Bullish
12.10.2020			U.S.A.	Europe	Emerging equities	JAPAN
			OVERWEIGHT	UNDERWEIGHT	OVERWEIGHT	OVERWEIGHT
Matrix recommended net exposure			22% 22%	21% -15%	29% 29%	16% 16%
	Weight CPD	Weight				
Trend (one month outlook in blue)	40%	40%	100% 100%	100% 10%	100% 100%	100% 100%
Contrarian trend			OB OS -11%	OB OS -8%	OB OS -14%	OB OS -9%
Relative valuation since 1995		20%	Exp. Cheap -88%	Exp. Cheap -82%	Exp. Cheap -88%	Exp. Cheap -66%
Liquidity delta		10%	Low High 100%	Low High 33%	Low High 74%	Low High 88%
Economics delta — Economic CPD		10%	Growing Faster -50% 0%	Growing Faster -50% -33%	Growing Faster 0% 60%	Contracting Slowe 0% -17%
Contrarian Sentiment	20%	20%	Neg. Po -31%	Neg. Pos 3%	Neg. Pos. -4%	Neg. Pos -73%
Investing Phases with Trend Charts			INVESTMENT	TRADING BUY	INVESTMENT	INVESTMENT



Source : Bloomberg – Stouff Capital

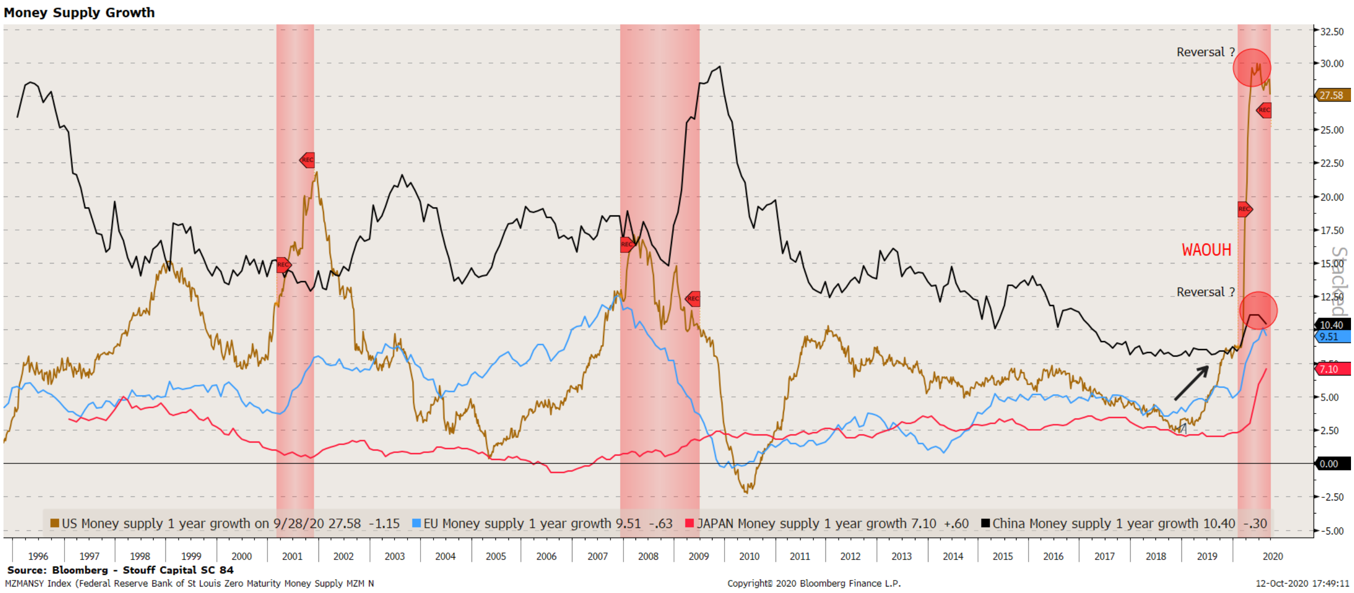
This matrix ranks from −100% to +100% the 4 regions (US, Europe, EM and Japan) with respect to 5 factors (Trend/Valuation/Liquidity/Economics/Sentiment). It suggests which region to overweight or underweight for a long only or a trader.

Our Matrix had switched in CPD (Change point detection = bearish) in August and recommended hedging our US and European exposures. This CPD state was cancelled when sentiment became too cautious by the end of September as indexes reached their wave 4 targets. Since the low, the Matrix has evolved to a bullish state, OW US but upgrading Europe to Neutral with a Trading Buy investing phase. Japan and EM stay OW. On the short run, our SC US sentiment will action a bearish signal when the index reverses by more than 1.5% from its high (SPX below 3,460-3,480). This is nothing to worry about, but just a possible range trading until the US election, which we manage through the purchase of upside convexity (Nasdaq 100 and single stocks chirurgical convexity on names implied by the outcome of the election like materials, health-cares, banks , Google etc…).

Liquidity

Liquidity in the euro area is downgraded from an additional €750bn of QE in Dec to €500bn at year-end and €250bn in June 2021 due to recent ECB commentary suggesting no urgency to act despite their own expectations of sub-2% inflation. For the rest of the world, liquidity stays ultra-strong. The delta between Europe and the ROW implies a higher Euro (target 1.2 or 1.25 in case of Blue wave victory). Money supply growth (chart 3) also shows a slight reversal from a very high level in all regions except Japan (Buy Japan). All in all, Liquidity stays a powerful bullish force for the next months thanks to Central banks accommodative policies.

CHART 3: MONEY SUPPLY GROWTH PER REGION - 12.10.20

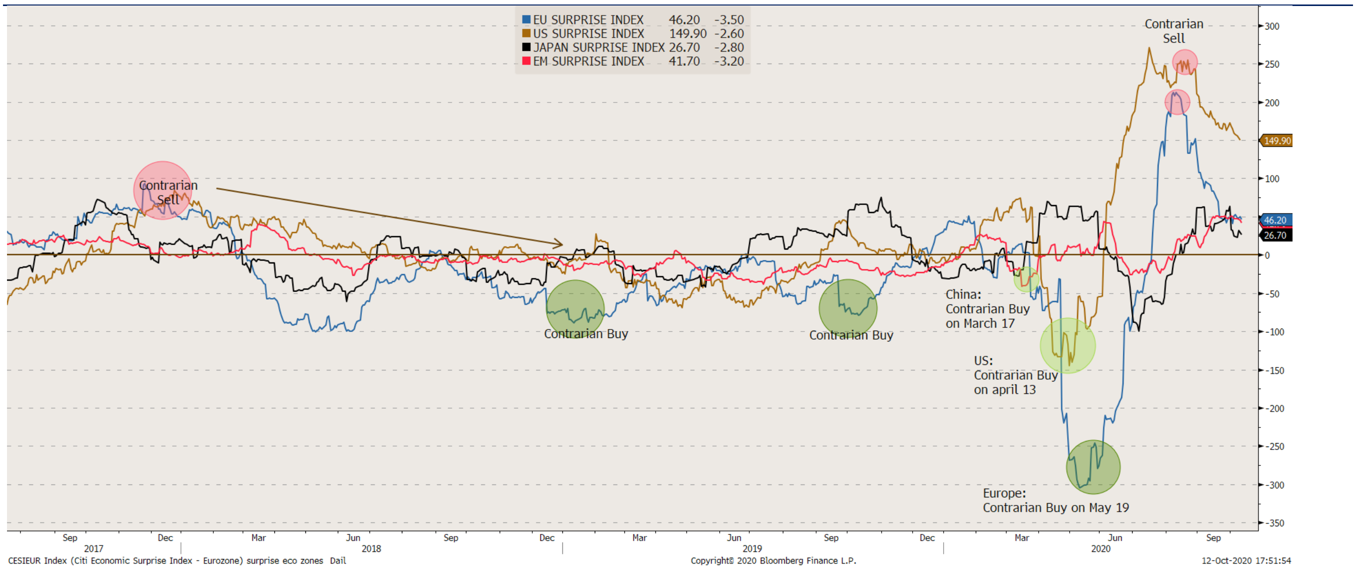


Source: Bloomberg –Stouff Capital

Economics

Our Economics grade had switched to CPD (Change point detection) as the Citigroup surprise indexes had turned south from elevated (historical high) levels. This week's data (US payrolls, PMIs) suggest that the global economy is slowing a bit again, but should still maintain an above-trend pace. A Democratic sweep would restore fiscal impulse into 2021 and gives a medium term extremely bullish signal.

CHART 4: SURPRISE ECONOMIC INDICATORS - 12.10.20

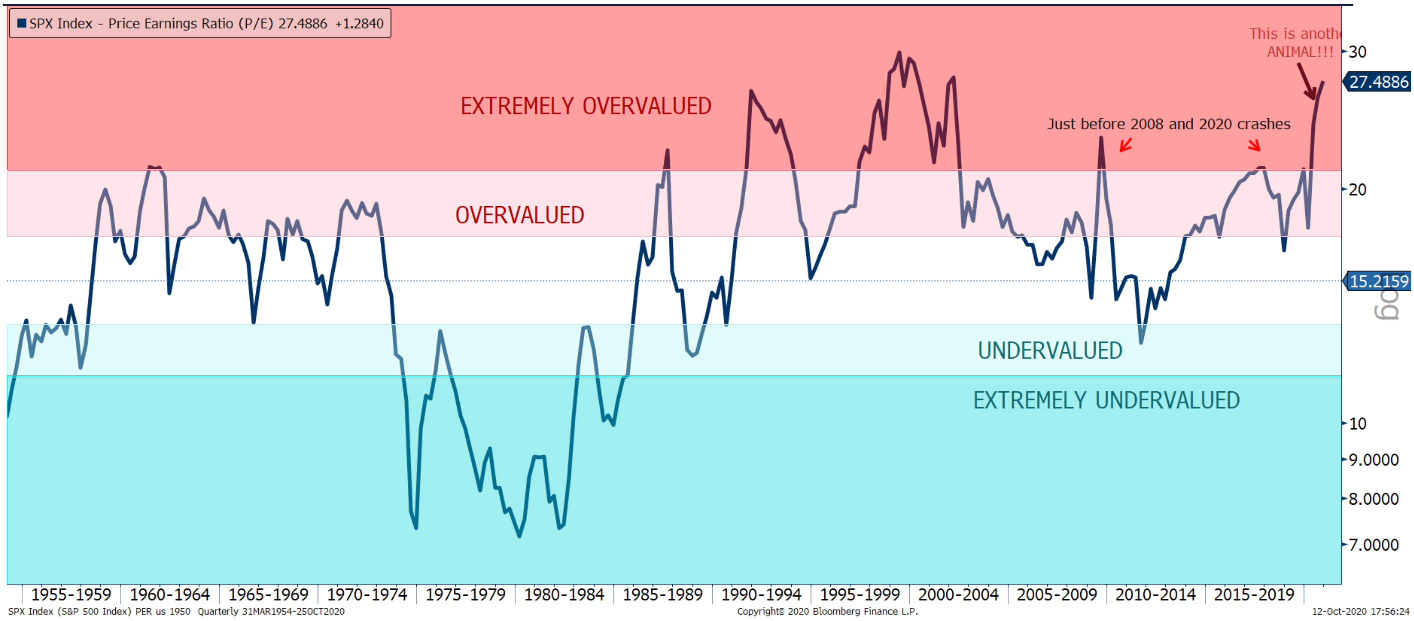


Source: Bloomberg –Stouff Capital

Valuation

Valuation stays extreme, but nobody cares as long as Central banks pump up the liquidity. The chart below shows that US P/E are not far from the 2000 levels. But in a world of 0% rates, most investors find equities cheap compared to long term and short-term yields.

CHART 5: S&P500 P/E SINCE 19958 - 12.10.20



Source: Bloomberg –Stouff Capital

Sentiment

Our SC US Sentiment has just flashed a possible short-term bearish signal (see chart 1), which will be triggered when the S&P500 reverses 1.5% from its intraday high (currently below 3500). This same indicator was especially useful to add risk when the S&P500 fell near 3,200on 23rd September. Our [Sector]Matrix is also giving Overweight (OW), Neutral and Underweight (UW) reviews on sectors. What strikes us this week? While Tech, Health-care stay OW in US, Staples has replaced Materials and Industrials in the OW category as investors are too optimistic (see Contrarian Sentiment line in the US Sector Matrix chart 6 below) on these sectors - probably helped by the "Blue Wave" trend. Looking at the "pans" sectors, Discretionary should be scrutinized as its sentiment (Contrarian Sentiment grade) is the most bullish at +11% (with staples at +20%), while its earnings momentum is the second best at +39% after Technology at +67%. For us, it means that smart money is buying this laggard while factors linked to the Covid19 are still awful. For our portfolios, it implied that we have reduced our shorts on discretionary and added new longs.

CHART 6: US SECTOR MATRIX 12.10.20

12.10.2020		XLF	XLE	XLV	XRT	XLI	XLP	XLB	VOX --> XLC	XLU	XLK	XLRE
Sector Grade (from -100% to 100%)		21%	-58%	40%	12%	33%	36%	31%	25%	7%	52%	27%
Period change												
S&P 500 Sector ranking		8	11	2	9	4	3	5	7	10	1	6
		Financials	**Energy**	**Health Care**	**Discretionary**	**Industrials**	**Staples**	**Materials**	**Communication**	**Utilities**	**Technology**	**Real Estate**
S&P 500 Weight per sector	100% Weight	10%	2%	14%	12%	8%	7%	3%	11%	3%	28%	3%
Trend	40%	50%	-100%	100%	100%	100%	100%	100%	100%	50%	100%	100%
Contrarian trend		-10%	7%	-11%	-13%	-13%	-11%	-11%	-5%	-22%	-9%	-9%
Relative valuation since 1995	15%	64%	-77%	-47%	-98%	-100%	-68%	-87%	-40% adjus. with GICS chg	-65%	-56%	-99%
Earning momentum	10%	-28%	-100%	-11%	39%	-56%	17%	17%	8%	-50%	67%	-22%
Short-term intra sector perf	10%	25%	0%	42%	67%	58%	8%	33%	17%	92%	83%	100%
		yield curv mortgage whol. Spr	Oil	Fed spending drugs deals >65 pop	apparel consumer watch. Sales	dur. Goods PMI manuf	beverage Cpi care Cpi tobac	PPI cement Steel cap uti	rates	rates, prod util.	Equp. Bookng mobile sales	Yield curves
Factors	10%	33%	100%	67%	-100%	100%	56%	0%	-100%	-33%	100%	-33%
Contrarian Sentiment	15%	-20%	-12%	10%	11%	-45%	20%	-43%	3%	-2%	-4%	7%
Weight (OW, Neutral, UW)		**N**	**UW**	**OW**	**UW**	**N**	**OW**	**N**	**N**	**UW**	**OW**	**N**
Catalyst (green: bullish; red:bearish)		(+) Deregulation, better balance sheets (-) Lower rates, defaults rising	Falling oil and shale companies unprofitable	2020 election headwind TOO EXAGERATED - Biden LEAD	covid19, unemployment spiking	increased fed spending - Biden infrastructure plan	covid19, grocery rush	Rebounding commodities	(+) FANG favored with covid19 (-) political headwinds FANG	Lower rates, low foreign exposures useless with lower dollar	(+) Trade deal coming, innovation cycle (AI, cloud) (-) GDPR, regulation	cloud industry warehouse REIT space, (-) covid19 headwind for rental
Sentiment details												
3month etf flows (3m=72,20d=26)	-194	-174	280	-498	606	2361	-618	1001	18	-336	-1304	-1529
20d etf flows (too high is negative)	2/3	-44%	4%	13%	3%	-70%	19%	-79%	11%	-6%	-29%	34%
smart sentiment	1/3	30%	-45%	5%	29%	5%	22%	28%	-13%	7%	46%	-47%

CHART 7: EUROPEAN SECTOR MATRIX 12.10.20

12.10.2020		SX7PEX	SXEPEX	SXDPEX	SXAPEX	SXNPEX	SX3PEX	SXPPEX	SXKPEX	SX6PEX	SX8PEX	SREEEX
Sector grade (-100 to 100%)		-6%	-41%	-2%	8%	20%	7%	27%	-42%	12%	43%	-33%
Period change												
Europe Sector ranking		8	10	7	5	3	6	2	11	4	1	9
		Financials	**Energy**	**Health Care**	**Discretionary**	**Industrials**	**Staples**	**Materials**	**Communication**	**Utilities**	**Technology**	**Real Estate**
Stoxx 600 Weight per sector	100% Weight	14%	4%	15%	7%	12%	18%	10%	4%	5%	8%	2.2%
Trend	40%	-39%	-70%	-20%	62%	100%	30%	100%	-70%	60%	100%	-40%
Contrarian trend		0%	1%	-3%	0%	-14%	0%	0%	-3%	-14%	-9%	-6%
Relative valuation since 1995	15%	26%	-90%	-45%	-96%	-98%	-93%	-81%	-57%	-81%	-42%	-97%
Earning momentum	10%	17%	-56%	18%	1%	-30%	33%	64%	-50%	-4%	-33%	4%
Short-term intra sector perf	10%	-71%	-100%	11%	36%	67%	11%	-28%	-45%	78%	55%	-11%
		yield curv Italy NPL TLTRO	Oil	drugs deals >65 pop	Retail sales German tyres autos	PMI manuf ind. Prod	beverage Cpi tobac	PPI cement Steel cap uti	rates	rates, nat gaz	Equp. Bookng mobile sales	rates
Factors	10%	58%	100%	100%	-44%	-7%	67%	-11%	0%	-17%	100%	0%
Sentiment	15%	38%	36%	9%	-12%	-21%	-12%	-23%	38%	-3%	5%	6%
Weight (OW, Neutral, UW)		**N**	**UW**	**N**	**N**	**OW**	**N**	**OW**	**UW**	**N**	**OW**	**UW**
Catalyst (green: bullish; red:bearish)		Lower Rates	Oil at multi-years LOW	product cycle COVID19	COVID19 impact fading ?	EU Recovery fund	COVID19 impact fading ?	(+) EU go green (-) EU go green	weak pricing and increased capex	Lower rates	Innovation cycle	Lower rates
Sentiment details												
3month etf flows	282	-67	-21	-21	108	177	12	192	-68	3	-32	2
etf flows	2/3	42%	30%	-11%	-11%	-31%	-31%	-33%	35%	-6%	11%	-4%
smart sentiment	1/3	28%	49%	49%	-14%	0%	27%	-4%	44%	4%	-6%	27%

Similarly, our EU Sector matrix is OW Tech, but favours cyclicals (Materials, Industrials and also Discretionary). This reinforces our call on the EU Recovery fund. Thinks to check are the very high contrarian bullish sentiment from smart money on Financials, Energy and Communications. To conclude, our Matrix(s) warns that a rotation towards cyclicals/ value/ high beta could continue and become very strong in case of a Blue Wave scenario – once again our favourite scenario with a 50% odd, versus 40% one month ago.

Trading Plan

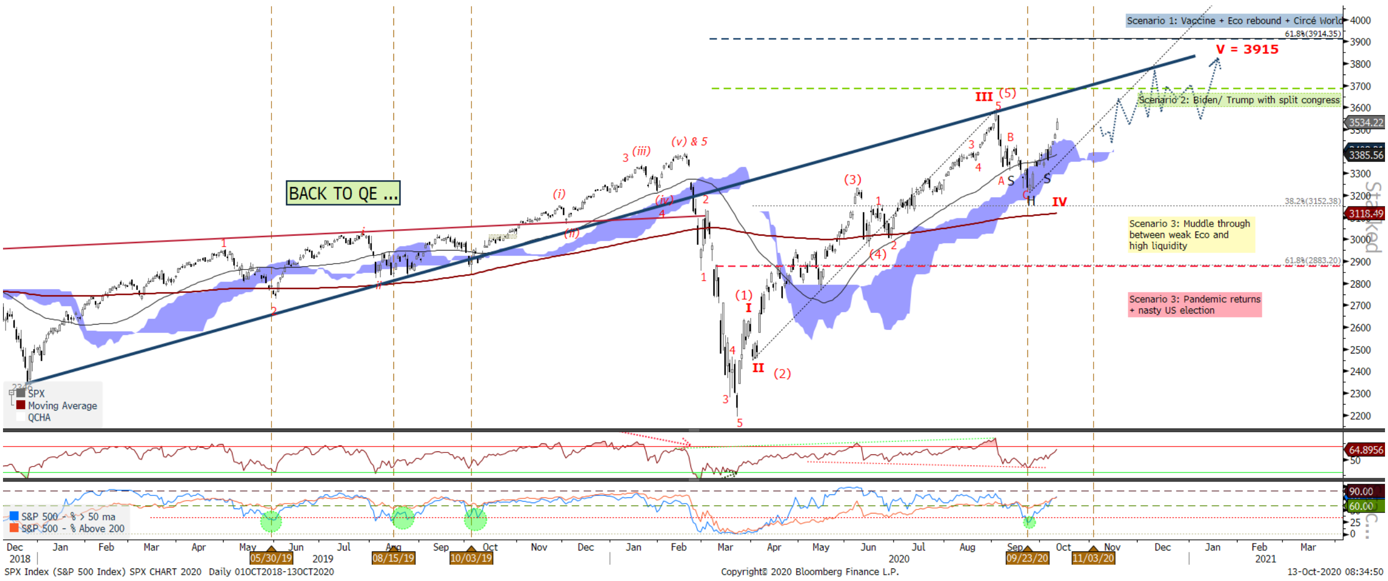
We have updated our scenarii for the end of the year as our wave 4 target has been reached. We think the extraordinary monetary conditions would send equities 10% HIGHER, if economic data rebounds more and the US election goes smoothy.

It means a first target of 3,690 for the S&P500, in case of Trump or Biden victory with a split congress. A Trump victory with a Republican senate would send the S&P500 towards its wave V target at 3915, which in terms of Elliott wave means a 61.8% extension from the wave IV. While we are mindful of the build-up of near-term uncertainties, we remain OW global equities on a medium/long-term basis.

In our favourite scenario - a Blue Sweep, US equities could fall first (while EM equities rise). This is driven by US stocks facing near-term tax uncertainty. This uncertainty is not shared by EM equities, which also benefit from a weaker USD and more multi-lateral foreign policy.

But, we think US equities could ultimately do well in a Blue Sweep, as a) it carries the highest odds of fiscal stimulus, b) we think tax increases could be delayed/diluted and c) a broader bull market trend remains dominate. Our 3,915 target could be reached sometimes in 2021. Our concern is simply about an initial, short-term market reaction. Therefore, we add convexity as implied volatilities have finally corrected to buyable levels.

CHART 8: S&P500 CHART - 12.10.20



Source: Bloomberg –Stouff Capital

Catalysts this week:

ECONOMIC DATA

- October 13 – Small Business Optimism, CPI, Weekly Earnings, Hourly Earnings
- October 14 – Mortgage Applications, PPI
- October 15 – Empire Manufacturing, Initial Jobless Claims, Continuing Claims, Philly Fed, Import Price Index, Export Price Index
- October 16 – Retail Sales, Industrial Production, Capacity Utilization, Business Inventories, Univ. of Michigan, TIC data

EARNINGS

- October 13 – BLK, C, DAL, FAST, FRC, JNJ, JPM
- October 14 – AA, BAC, GS, PGR, PNC, UAL, UNH, USB, WFC
- October 15 – ISRG, MS, OMC, SCHW, TFC, WBA
- October 16 – ALLY, BK, CFG, ETFC, GPRO, HON, KSU, SBNY, SLB, STT, VFC

The Equity quantitative grades

EPS Growth Grade: The EPS Growth Grade is a proprietary formula made up of earnings revisions momentum, past earnings growth, earnings stability, and current and long-term earnings growth. A grade above 55 is considered bullish on a 3-month basis, bearish below 45 and neutral between 55 and 45.

Sales Grade: The Sales Grade is a proprietary formula made up of current and next year's sales momentum, past sales growth, sales stability, and current and long-term sales growth. A grade above 55 is considered bullish on a 3-month basis, bearish below 45, and neutral between 55 and 45.

Relative Value Grade: The Relative Value Grade is a proprietary formula made up of estimated P/E, P/B, P/S and P/CF ratios. 40% of the grade is based on historical values and 60% on current market data. A grade above 55 suggests a stock is cheap, below 45 expensive, and neutral between 55 and 45.

Quality Grade: The quality rating is a proprietary formula that focuses on the balance sheet (i.e. change in accruals, change in free cash flows and profitability). A grade above 55 suggests a stock with a good balance sheet.

Volume Flow Grade: The Volume Flow Grade is a proprietary formula that gives the accumulation/distribution based on the volume flows of a stock. A grade above 55 indicates good money flow and a grade below 45 suggests weak money flow.

Global Grade: The Global Grade is a weighted average of the Growth, Value, Berkshire, Quality and Money Flow Grades.

Relative Strength (RS) Grade: The RS grade measures the price momentum of a stock over its 1-year price performance.

Smart Sentiment Grade: Sometimes referred to as "Smart Sentiment," the Sentiment Grade ranks the sentiment of the smart money. The first digit of the figure goes to the level of bullishness, and the second digit goes to predictability. For example, a sentiment grade of 97 indicates 90% bullishness and 70% predictability.

The Regional MATRIX grades

The Regional Matrix grades range from -100% to +100%. We consider a grade above 30% to be very bullish, a grade above 10% to be bullish, and a grade between -10% and 10% to be neutral. A grade between -10% and -25% we consider bearish and a grade below -25% very bearish. This Regional Grade is a benchmark for the net exposure of the Urizen Fund.

Regional Grade: The Regional Grade (-100 to +100) is an indicator of a structural bull market or not. It is calculated by combining and applying weight to each of the other grades that make up the Regional Matrix (Trend, Contrarian Trend, Relative Valuation, Liquidity delta, Economics delta, and Contrarian Sentiment). If we believe equities to be in a structural bull market, we use 15 years of data to assess Valuation.

Trend Grade: The Trend Grade (-100% to +100%) is based on a moving averages model adjusted according to the overbought/oversold conditions of the region's main indices.

Relative Valuation Grade: The Valuation Grade (-100% to 100%) is based on the percentile rank of the regional Index stocks' P/E ratios since 1995 (current year estimated).

Economics delta Grade: The Economics delta Grade (-100% to 100%) is based on a combination of manufacturing and non-manufacturing PMIs and the Citigroup Surprise Indices. The Citigroup Economic Surprise Indices are an objective and quantitative measure of economic news and are defined as weighted historical standard deviations of data surprises (actual releases vs. Bloomberg survey median). A positive reading of the Economic Surprise Index suggests that economic releases have on balance beaten the consensus.

Contrarian Sentiment Grade: The Contrarian Sentiment Grade (-100% to 100%) is based on various contrarian and non-contrarian indicators.

The SC quantamental portfolios

The SC quantamental portfolios refer to our regional single stocks portfolios which are constructed through a mixed process of algos and fundamental analysis