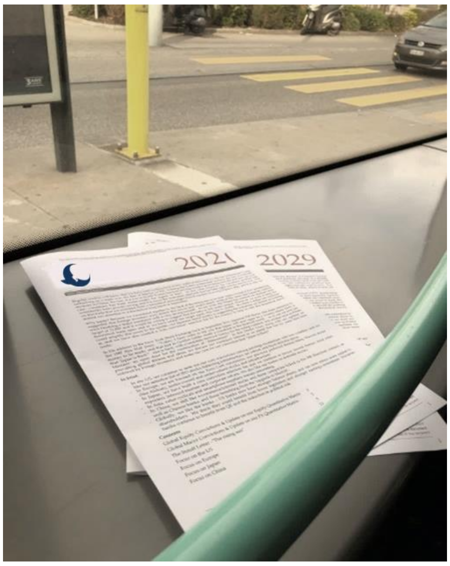
Global Equity Long-Short Quantamental Strategy

Stouff Capital

Update as of December 24th, 2021 | Letter 70

Back to the Future

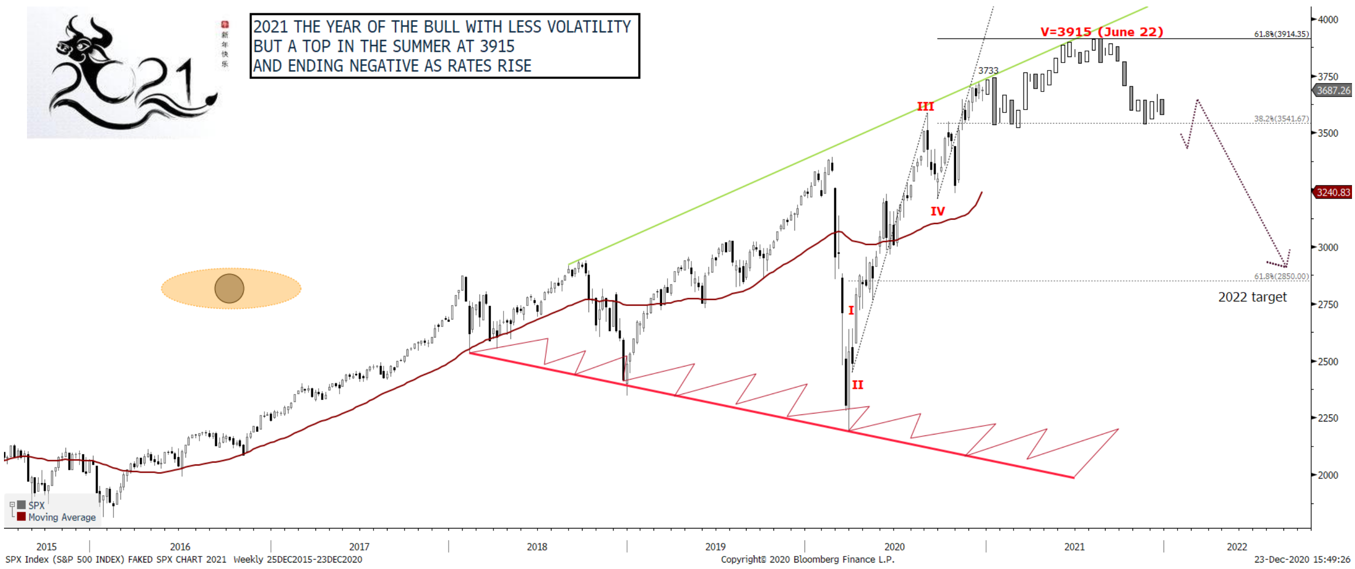
On our way to work this morning, we came across two editions of our letters at the back of the tram… We looked around to see who had discarded them, then saw to our surprise that they were dated 24 December 2021 and 19 October 2029! Once again, we had stumbled upon two editions of our publication… from the future! We looked around again (this time to be sure that nobody had noticed our valuable discovery), and hastily delved into the pages... In this special 'Back to the Future' letter, we look back over 2021, and present some insightful extracts from our recently discovered editions from the future: read on at your peril…



Letter 70 : December 24th, 2021

After the outbreak of the pandemic and economic crisis in 2020, the year of the Ox brought us some energy of calm (VIX back to 15 in March) and steady pace to help us recover from 2020. In the Chinese Zodiac, the year of the Metal Ox is a favorable year for economic recovery and for creating a reserve stock for the coming unproductive years. But 2021 was a year when only hard work and method were rewarded, with fortunately no explosive or catastrophic events. The 2021 year of the Ox favored investors who stayed prudent and patient. Indeed, while the new year started with a stimulus deal in Washington, a Brexit agreement and the start of the vaccination campaign, which propelled global equities to all time high, a steep "buy the rumour, sell the fact" 6% sell-off after the runoff elections in Georgia on January 5th (confirming the Senate remaining Republican) gave an *avant-goût* for the rest of the year. While the Uncle Sam index managed to recoup its loss and rose slowly towards its wave V target at 3915 on June 21st, the summer solstice marked the high for the year. The crocodile jaws were about to snap as shown on chart 1. This was all the more surprising than the consensus was for a strong S&P500 with a high target at 4,400 and hedge funds' exposure to stocks was at its highest in a decade while money managers had only 4% in cash.

CHART 1: NEGATIVE YEAR FOR THE S&P500 - to 3766 highs in January 2021, falling to 3521, rebounding to 3915 on summer solstice, then falling to 3541



Source: Bloomberg – Stouff Capital

Indeed, while earnings **rose by more than 20%** to 175 and US growth was a stunning **6.5% versus an expected 4%** (thanks to vaccine rollout and stepped-up therapeutics ramp reopening efforts), rising long term rates put pressure on valuations, specifically those of high-priced growth stocks in the tech, communications-services, and consumer-discretionary sectors. The market is now down for the year, as multiples contract with higher discount rates.

2021 saw investors rotating out of highflying big tech and into cheaper, more economically sensitive stocks. But as tech is 30% of the S&P 500, Uncle Sam index found it difficult to make a lot of headway. To the contrary, high "Covid beta"—the ones most sensitive to the market's rise and fall, based on good or bad coronavirus news—benefitted the most as life returns to normal. They included for instance Darden Restaurants (DRI) in chart 2, which gained 55% year to date. Financials also fully benefited from the rise of 10yr interest rates above 1.65%. Goldman Sachs, one of our best ranked US banks at the start of the year broke out its 5 years resistance zone and rose 39% (chart 3).

CHART 2: BUT STRONG YEAR FOR THE RESTAURANT STOCK DARDEN

Source: Bloomberg – Stouff Capital

CHART 3: AND GOLDMAN SACHS

Source: Bloomberg – Stouff Capital

CHART 4: THE DOLLAR ROSE IN 2021

Source: Bloomberg – Stouff

To the surprise of many but not us (our inflation expectation model was forecasting its rebound – red line of chart 4), the dollar went up in 2021 and as of now is up 5% versus the Euro at 1.1567. The U.S. adopted a policy of favoring a "strong" dollar in 1995, until President Trump communicated in 2017, that the dollar was "getting too strong", and that a weaker currency would help American exports. Yellen, the new Treasury secretary saw a weaker currency as a help in addressing the country's current-account deficit. But favoring a strong dollar was "prudent" for the incoming secretary, in particular given Biden's plans for expansionary policy. The return to a strong dollar communication stopped its debasement. It was critical to keep the trust in the US federal debt larger as a share of the economy than at any time since the end of World War II.

This rebound of the dollar explained also why the DAX and the Nikkei have been so strong this year and why Emerging equities have under-performed, *contrary to the consensus*. Chart 5 shows that the DAX is up 26.5% year to date, or one of its best relative return versus the S&P500.

CHART 5: THE DAX IS THE BIG WINNER IN 2021

Source: Bloomberg – Stouff Capital

CHART 6: EQUITY REGIONAL GRADES, MATRIX 29.12.20

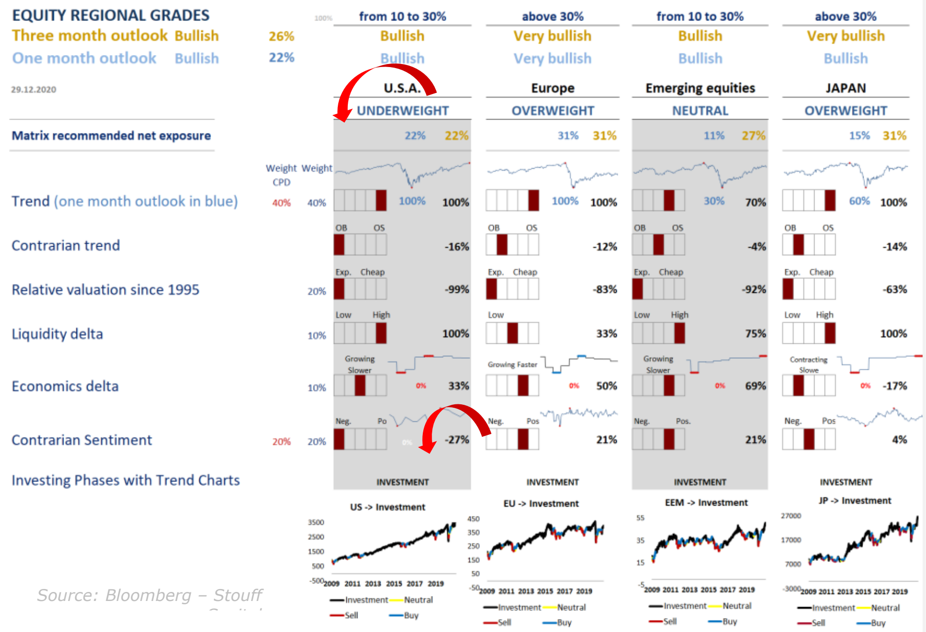


CHART 7: US SECTOR MATRIX 29.12.20

29.12.2020		XLF	XLE	XLV	XRT	XLI	XLP	XLB	VOX --> XL	XLU	XLK	XLRE
Sector Grade (from -100% to 100%)		50%	25%	47%	17%	24%	39%	38%	20%	9%	45%	13%
S&P 500 Sector ranking		1	6	2	9	7	4	5	8	11	3	10
		Financials	Energy	Health Care	Discretionary	Industrials	Staples	Materials	Communication	Utilities	Technology	Real Estate
S&P 500 Weight per sector	100% Weight	10%	2%	13%	13%	8%	7%	3%	11%	3%	28%	3%
Trend	40%	100%	70%	100%	100%	70%	100%	100%	100%	40%	100%	70%
Contrarian trend		-13%	1%	-5%	-10%	-4%	-4%	-4%	-16%	8%	-19%	2%
Relative valuation since 1995	15%	41%	-99%	-47%	-98%	-100%	-61%	-85%	-46% adjus. with GICS chg	-8%	-59%	-95%
Earning momentum	10%	55%	-28%	11%	22%	-50%	-6%	-17%	-33%	-44%	50%	-6%
Short-term intra sector perf	10%	67%	8%	58%	50%	25%	42%	33%	75%	0%	92%	83%
		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 uti	Equp. Booking mobile sales	Yield curves
Factors	10%	33%	100%	100%	-33%	75%	33%	33%	-100%	-67%	100%	-33%
Contrarian Sentiment	15%	-41%	-45%	-7%	11%	-18%	19%	-17%	-6%	17%	-18%	-36%
Weight (OW, Neutral, UW)		OW	N	OW	UW	N	N	N	N	UW	OW	UW
Catalyst (green: bullish; red:bearish)		(+) Deregulation, better BS, split congress (-) Lower rates, defaults rising	Falling oil and shale companies unprofitable	No blue wave scenario	(+) Opening economy (-) Covid19	increased fed spending - Biden infrastructure plan	(+) Covid19, grocery rush (-) Opening economy	Rebounding commodities	(+) FANG favored with covid19 (-) political headwinds FANG	Higher rates, low foreign exposures useless with lower dollar	(+) innovation cycle (AI, cloud) (-) GDPR, regulation	cloud industry warehouse REIT space, (-) covid19 headwind for rental
Sentiment details												
3month etf flows (3m=72,20d=26)	11010	4124	2805	212	1206	2132	-631	784	210	65	228	-125
20d etf flows (too high is negative)	2/3	-78%	-70%	-29%	1%	-32%	18%	-27%	-29%	26%	-39%	-50%
smart sentiment	1/3	32%	4%	38%	32%	12%	21%	3%	41%	-2%	25%	-9%

Source: Bloomberg – Stouff

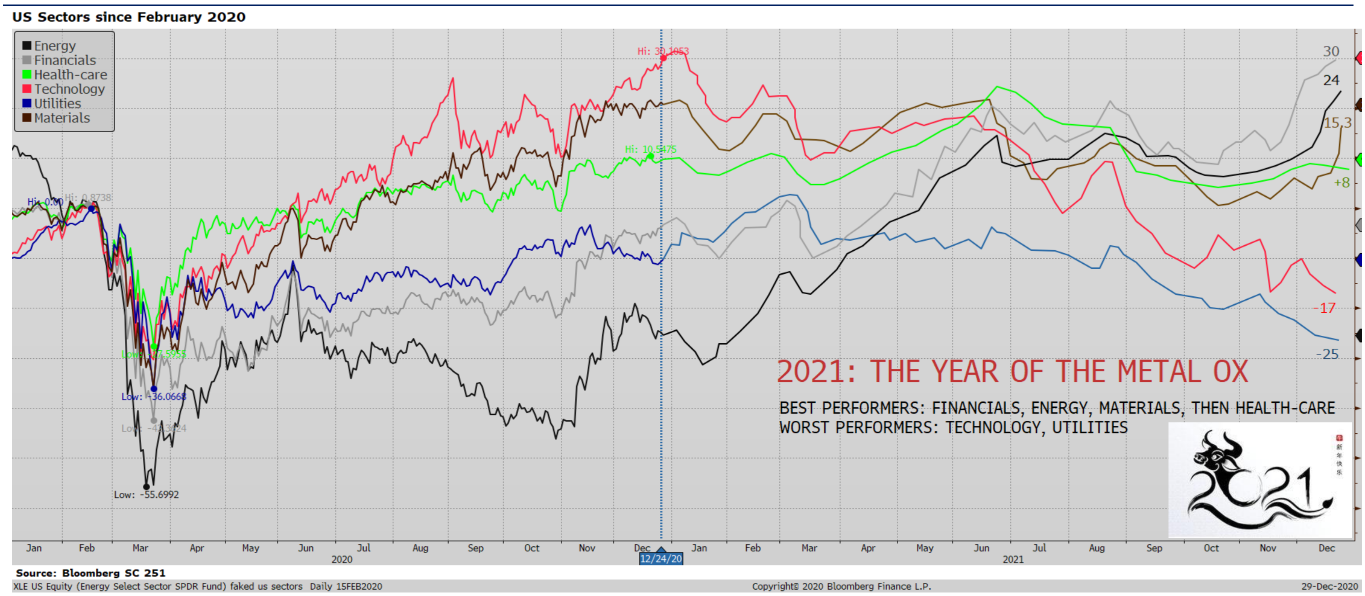
Retrospectively, our regional Matrix was right in its Underweight stance on US equities, neutral on EM and overweight on Europe and Japan, as shown in the chart 6.

It was also giving a cautious stance for the start of the year as US Contrarian Sentiment was very bearish. Indeed, it was not a smooth start to the year.

The beginning of 2021 was characterized by a strong and consensual bullish market sentiment which propelled global stocks to one of the best last week of the year's performances seen in many decades. This was not to last, and the S&P 500 subsequently fell 6% after the 5th of January.

From a sector point of view, our US sector matrix recommendations played out quite well in 2021. Financials, Materials and Energy all outperformed. Their relative performance versus the S&P500 specifically increased as long-term rates rose after March. Healthcare did well as the Blue wave scenario was definitely dismissed after the 5th January Republican Senate victory. To the contrary, Technology and sectors hurt by higher rates like utilities were down double-digit.

CHART 8: US SECTOR RETURNS IN 2021



So, turning back to our Letter of December, what other clues did it give us for 2021? Below is a list of predictions for 2021 based on our discovered publication – let's see if these events play out, or whether those time travelers are already at work tinkering with the future…

- UK becomes the new economic miracle as Boris Johnson's boosted confidence; the FTSE 100 is the best performing index in Europe;
- The Energy sector is the best performer in 2021;
- The Technology sector is down more than 20%, while IPOs are down -30%. Cybersecurity becomes a major headwind, that US big Tech cannot contain;
- While Apple unveils its iCar (see photo), Tesla makes a bid on Apple. This is also a direct personal revenge as Elon Musk was humiliated by Tim Cook's refusal to meet him a few years ago to sell Tesla at $60 Billion;

- Zombies companies become the largest tail risk for markets, with massive default rates, hurting high yields as an asset;
- Bitcoin reaches $ 50,000 owing to the return of the "animal spirit" and as more investors embrace its rise. Commodities confirm their reversal from a decade bear market, with copper rising by 50% or Soybeans doubling. This looks like the start of a new Commodity bull cycle. The dollar stayed weak initially before making a strong comeback with higher real growth and higher real long-term rates;
- The new geopolitical order creates rising tensions between (1) Taiwan, China and multiple other actors in the South China sea, (2) Russia and Poland, (3) Israel, Saudi and Iran, that leads to a major assault on oil infrastructure and ensuing disruption;
- Republicans keep control of the Senate. US growth is above 6% and Biden's approval rebounds after the benign consequences of its son's investigation;
- Regulation intensifies on Bitcoin and the FANGs;
- Russia is one of the best EM performers in 2021 while Chinese equities finish on a negative score as Xi Jinping's soft power has been eroded owing to the break-up of Alibaba and Tencent;
- 2021 sees a return to lower volatility: the S&P500 never makes a correction of more than 10% in 2021 while the VIX falls to 15 in March before rebounding between 15 and 20%;
- Twitter and Snap merge.

When we looked at 2029's Letter, we were astonished at the extent to which it differed from our letters of today - (to the point where we are not really sure what they (or us) in the future are talking about!) Here are a few extracts: "19 October 2029: Our provocative forecast on the Moody's 500 (previously the S&P500) has been reached (figure B1). Looking back over the past decade, what followed the Covid19 virus represented the longest stretch of growth and geopolitical visibility in a decade. Strong growth, tame inflation, cash rates at or below zero, and double-digits trillions of dollars of central bank liquidity were blissful for markets in general. Uncle Sam's index climbed relentlessly, after a complicated period between June 2021 to March 2023, when it corrected by approximately 20%. This consolidation enabled the index P/E to fall to 20, creating the ammunition for the exuberant rise we have seen over the past five years since March 2023 as forecast by the Confidence model in Figure B2. P/Es are now above 30, but investors tell us that this time it is different, with accelerating technological and social progression justifying the never-ending expansion of P/Es (although we have our doubts, and respectfully suggest our regular readers be fully hedged).

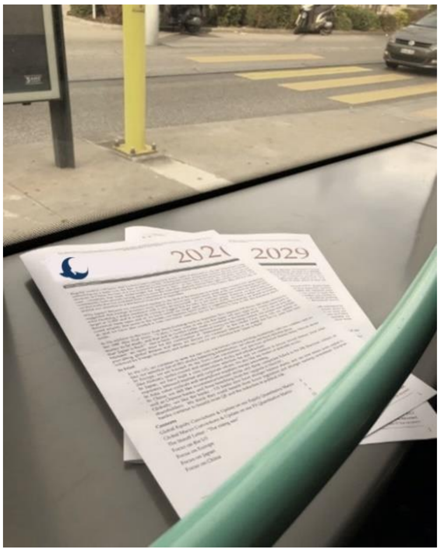


Figure B1: Moody's 500 Index: 10,000 reached 19 October 2029

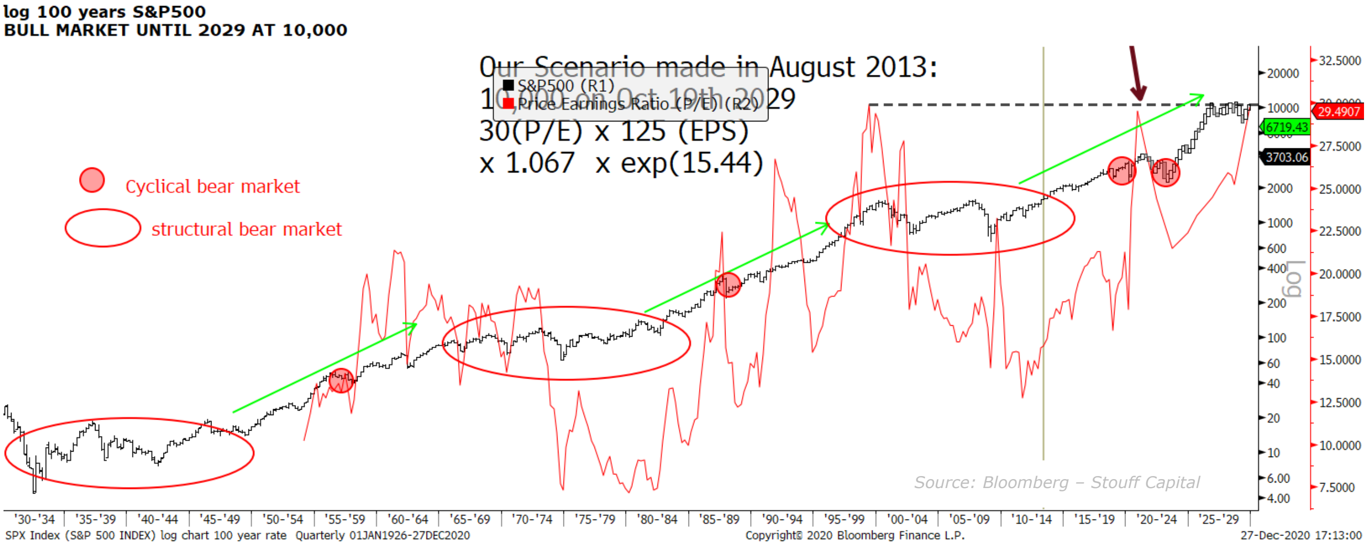
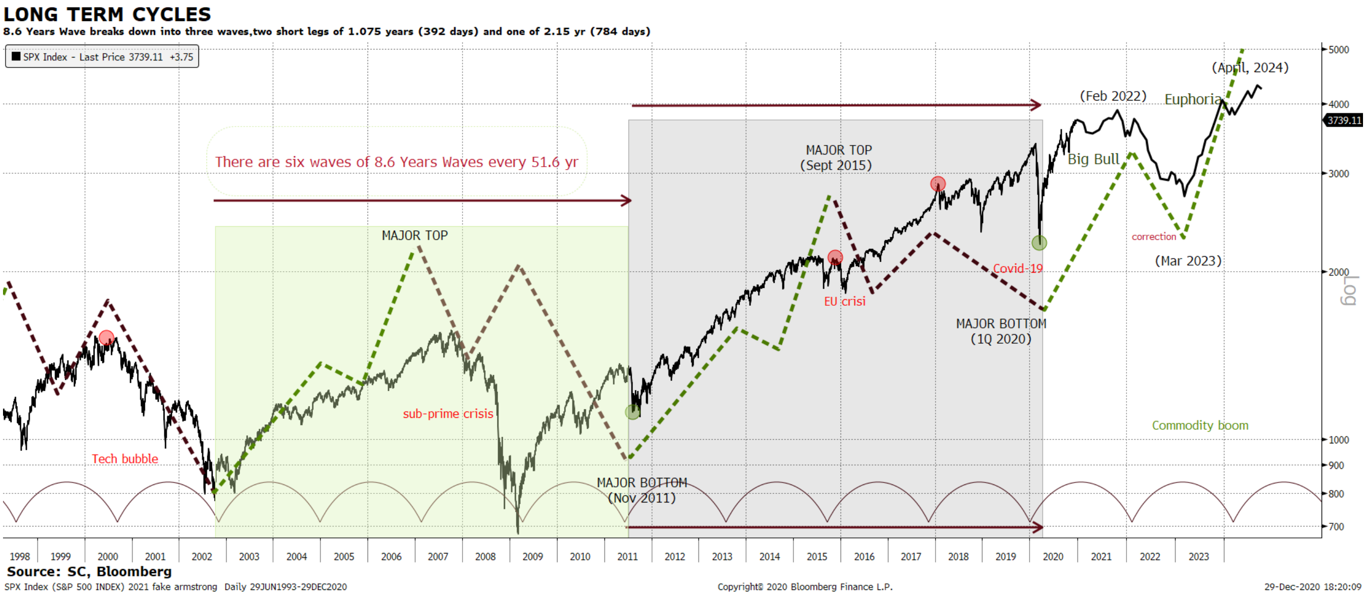


Figure B2: The Confidence Model kept forecasting perfectly the fall and rise of US equities until the end of 2024



The big new trend : Singularity – the acceleration of technological progress and the technological tipping point

By the end of this century, the non-biological portion of our intelligence is expected to be trillions of trillions of times more powerful than unaided human intelligence. We are now in the practical stages of 'the Singularity'; the period during which the pace of technological change is so rapid, and its impact so deep, that human life will be irreversibly transformed. Back in 2017, the futurist Ray Kurzweill was quoted on Futurism.com saying that "*2029 is the consistent date I have predicted for when an AI will pass a valid Turing test and therefore achieve human levels of intelligence*".

The exponential growth of the capacity of information technology has now outpaced the "knee of the curve", the stage at which an exponential trend becomes noticeable, and the trend has quickly become explosive. From a strictly mathematical perspective, growth rates will still be finite, but so extreme that the changes they bring about will appear to rupture the fabric of human history. The twentieth century's achievements were equivalent to about twenty years of progress at the rate of 2000. By 2015, we had made twenty years of technological progress in just fourteen years, but needed only 7 years to do the same again. To express this another way, we are doubling the rate of progress every decade; we'll see the equivalent of a century of progress – at today's rate - in only twenty-five years. For the entire twenty-first century, we expect to witness around twenty thousand years of progress (again, when measured by today's rate of progress). For instance, EV sales increased 30-fold from 2020 to 2029, from 2m to 60m or 60% of the market.

This phenomenon is enabled by the maturing phases of various technologies including DNA sequencing for gene therapies, human robotization, nano-sciences, computer-brain interfaces, human augmentation, quantum computing, mobile robots, energy storage, artificial intelligence, blockchain technology for cryptocurrencies and so on. The current existing listed companies in this area are Tesla, General Electric, Rockwell Automation, Hewlett 3D (merger between IBM, 3D and Hewlett-Packard), Oracle-Salesforce (merger of Oracle, Nvidia and Salesforce) and Google (merger of Alphabet et Disney). The table below shows how members of the Dow Jones evolved, compared to 1999 and 2013. While winners won in a big way, disruptive innovation dislocated those so-called value traps - stocks that were cheap for a reason - like petrol-powered cars, traditional healthcare or middlemen. More broadly, those innovations kept inflation low, except during the 2021-2024 commodity boom.

1999	2013	2029
Alcoa Incorporated	3M Company	Alcoa
AlliedSignal Incorporated	Boeing	**Boeing**
American Express Company	Cisco Systems	**Cisco Systems**
AT&T Corporation	ExxonMobil	**Chevron ExxonMobil**
The Boeing Company	The Home Depot Inc	Fiat Chrysler Automobile
Caterpillar Incorporated	Johnson & Johnson	Actavis & Johnson
Citigroup Incorporated	Merck & Co.	Merck & Gilead Sciences
Coca-Cola Company	Pfizer	ABC (Amgen-Biogen-Celgene)
E. I. du Pont de Nemours	UnitedHealth Group	CVS Health Corp
Eastman Kodak Company	Visa	LinkedIn Corp
Exxon Corporation	American Express Co	Mastercard
General Electric Company	Caterpillar	Rockwell Automation
General Motors Corporation	The Coca-Cola Company	**The Coca-Cola Science Co**
Hewlett-Packard Company	General Electric	**General Electric**
Home Depot Incorporated	Intel	**Intel**
Intel Corporation	JPMorgan Chase	**JPMorgan Chase**
International Business Machines	Microsoft	Apple
International Paper Company	Procter & Gamble	**Procter & Gamble**
Johnson & Johnson	United Technologies Corp	**United Technologies Corp**
J.P. Morgan & Company	Walmart	Amazon-Visa
McDonald's Corporation	AT&T Inc	Google
Merck & Co., Inc.	Chevron	Tesla
Microsoft Corporation	DuPont	Hewlett 3D
Minnesota Mining & Manufacturing	Goldman Sachs	BlackRock
Philip Morris Companies Inc.	IBM	Oracle - Salesforces
Procter & Gamble Company	McDonald's	Starbucks
SBC Communications Inc.	Nike Inc.	**Nike Inc.**
United Technologies Corporation	The Travelers Companies	AIG
Wal-Mart Stores Incorporated	Verizon Communications	Facebook
Walt Disney Company	The Walt Disney Company	Netflix

Source: Bloomberg – Stouff Capital

The over-60 population has exploded, fortifying health-care and financial companies (Figure B3). The healthcare sector has seen the creation of many important sub-industries which have outpaced our old sectorial matrix, and the sector now represents 30% of the equity market. Among the most significant sub-industries to emerge are those centred around cardiovascular diseases (1/3 of global deaths), dental care, hearing loss, dementia (a USD1.12tn market), Alzheimer's and diabetes (which now affects more than 600m people, the 7th highest cause of death, and a USD200bn market). DNA sequencing technologies have become a USD100bn market, growing 30% per year since 2014. The names which currently lead this market are: Merck & Gilead Company, Sanofi & Johnson, CVS Health and ABC (Amgen/Biogen/Celgene). Financials have moved towards asset and wealth management, mainly due to the shift of pension provision from state to private, resulting from the failure of governments to secure pensions owing to an ageing population, and resulting in a powerhouse industry in financial insurers and wealth managers. Back in 2014, only four out of 10 US retirees used a financial advisor; since then, the now USD75tn market has changed, with the set-up of a risk-controlled investment paradigm owing to the over 60s considerable share in the investment community. Leading companies in this sector in 2029 are JPMorgan and Blackrock.

Another surprising social trend that has emerged since 2015 is the **reduction in the supply of workers in many of the world's largest economies.** Countries need to look across borders for mobile and willing job seekers. LinkedIn has been the strongest beneficiary of this trend. The labour supply shrank in Germany, Poland, Russia, and Japan up until 2020. From 2020 to 2030, workforce contraction has accelerated. Europe has been severely affected, and for the first time, South Korea and China have seen a decline. Everywhere else, the labour supply has expanded but at a slow pace **(See figure B4).** The labour gap by country has been a good predictor of the performance of their respective equities and bonds. The US, UK, Spain, Sweden, South Africa, Turkey, India and Argentina have been the winners over the last 15 years.

Figure B3: Demography per region

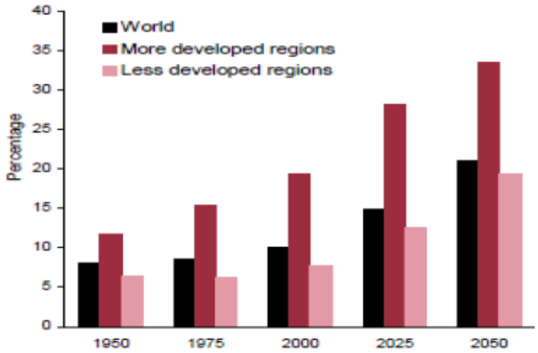


Figure B4: Labor supply growth rates

The German philosopher Arthur Schopenhauer said that: "Every man takes the limits of his own vision for the limits of the world". The paired discovery of our future Letters has certainly enlarged ours. We will have to wait one year and then 8 more, this year again, to verify if these lost reports on the back of the tram were a divine intervention or just a joke. Besides, we were amazed to discover the faces of our 2029 aged team:





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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