

Likes/Dislikes – October 8th, 2021

Below are Evergreen Gavekal's Likes/Dislikes for October 8th, 2021.

OUR CURRENT LIKES AND DISLIKES

Changes highlighted in **bold**.

The S&P 500 started the week with a thud, continuing the correction that started last month. However, its remarkable resilience reasserted itself over the next few trading days by clawing back almost 3% which almost exactly what it is now down from the early September peak. Barring a late day swoon, this will be the S&Ps best week since June.

The postponement (can kicking?) of the debt ceiling impasse definitely provided a boost. This avoided what could have been the catalyst for an October market bloodbath had the US defaulted. Even today's weaker than expected employment news hasn't fazed stock prices. Nor has the continuing rise in the 10-year treasury note's yield to slightly above 1.6%. That is up over 4/10% (about 43 basis points) from this summer low point.

Delta infections continue to recede, improving the odds of another reopening spurt, similar to last November's vaccine-driven surge, though likely not as strong. It remains my view that the next few quarters should bring surprisingly robust economic news as a function of both a relaxation of pandemic restrictions and the gradual release of roughly \$2.5 trillion of excess household savings built up during the lockdowns. This bodes well for continued outperformance by more cyclical stocks.

Another boost for value issues is the rise in longer term rates with short rates staying down. This creates a steeper yield curve (greater spread between long and short rates), benefiting the financial sector which is one of the most important in the value universe.

Energy continues to be in the spotlight, particularly in Europe. As noted in today's main *EVA* section, natural gas prices on the Continent are now the equivalent of \$200 a barrel oil! Consequently, Europe is experiencing a full-blown energy crisis, as is much of Asia. The Chinese government has instructed its power providers to secure energy resources regardless of cost.

Based on what's happening in Europe and Asia, it's probable that countries will build up considerable reserve supplies of oil, gas, and, even, coal to avoid future debilitating shortages once current extreme prices recede somewhat. This should further increase the demand for traditional energy sources. One of the worst aspects of this third energy crisis (the first two being in the 1970s) is how much coal usage has increased since this is the dirtiest form of fossil fuels.

Evergreen continues to be bullish on the energy sector, as well as other natural resource-based securities, including those that are essential for the transition to renewables and electric vehicles. We believe the Green Energy Transition requires a realistic and gradual shift from fossil fuels to renewables to avoid the type of chaos being seen in Europe presently.

- Large-cap growth. (For the most part, there continues to a better risk/reward ratio with growth-at-a-reasonable-price—GARP—type issues; as with the overall US stock market, bargains are increasingly scarce, though there has been some value restoration lately.)
- Certain international developed markets, especially Japan (The Japanese market has continued to move higher and has achieved a multi-year breakout, boding well for future gains. It remains an excellent way to benefit from the next leg up in the global economy once the Delta variant is perceived to be under control.)
- Publicly traded pipeline partnerships, i.e., MLPs and other mid-stream energy securities. (MLPs have had an extraordinary run since last November, despite a 19% correction from their June peak to the low seen, for now, on August 19th. Even so, the MLP index is up roughly 41% on a total return basis for the year and it successfully held the 8/19 low in recent weeks.)
- **Gold-mining stocks (The miners have been stabilizing after a rough summer; I continue to expect a powerful rally in this group soon.)**
- Gold (Its recent weakness is likely just a pause in a powerful long-term up-trend.)
- **Silver (It has been lagging gold lately. However, it may be poised to soon outperform the yellow metal based on the growing odds of better economic news over the next few quarters; silver is both more volatile and economically sensitive than gold.)**
- Select international blue chip oil stocks (Despite the aforementioned snap-back, energy shares remain exceedingly depressed with many producers trading at double-digit free cash flow yields; some of the mid-sized companies have free cash flow yields in excess of 20%.)
- Short-term investment grade corporate bonds (1-4 year maturities; favor shorter maturities due to rising inflation risks because of the likelihood that the Fed and the Treasury are over-stimulating the US economy.)
- Emerging market (EM) bonds in local currency (focusing on stronger countries, particularly in Asia)
- Large-cap value (This major style has been lagging its growth counterpart in recent months, making it look relatively more attractive, notwithstanding a mild recovery since mid-July. It should be a beneficiary of the second economic reopening phase.)
- **High-dividend equities with safe distributions (A number of these have fallen further due to Delta variant worries which, as indicated above, are receding.)**
- **Most cyclical resource-based stocks (Previously, we recommended some profit-taking which turned out be decent advice; now, as described above, it's timely to look for bargains in these issues. Copper issues in particular look interesting due to a demand spike that seems inevitable, as a result of the electric vehicle push, along with challenged supply.)**
- BB-rated corporate bonds (Buy more selectively after a spectacular rally and favor shorter maturities.)
- Canadian REITs (Avoid office issues for now.)
- **South Korean Equities (Delta variant concerns have hit the Korean market much more than the S&P 500; the former is now down 16.5% from its early year peak. We like its long-term prospects.)**
- **Uranium and uranium producers (The world's leading uranium miner has vaulted 139% since early November, validating our positive stance on this sub-sector. Due to its big move, hold off on new purchases particularly given the recent surge.)**
- **Certain "Virus Victim" equities such as refiners, homebuilders, and select retail stocks (After a powerful rally in homebuilders and a number of retailers, be more selective; certain homebuilders have had significant pullbacks due to the interest**

rate rise.)

- Investment-grade floating rate corporate bonds (Despite a vigorous rally in recent months, there remains decent long-term value in this bond market niche.)
 - **The higher quality mortgage REITs (Previously, we'd advise profit-taking on these but higher bond yields has triggered enough of a correction to warrant renewed accumulation. A steeper yield curve is a positive for this sub-sector.)**
 - Floating rate bank loans (Although GDP growth this quarter is likely to be much slower than Q2, this should be a pause not a reversal. Thus, the still healthy US economy reduces default risks and the floating-rate structure of bank loans mitigates inflation risks.)
 - Copper producers. (Moving these to Like based on both the retracement they've had and the looming demand boom due to drastically increased electric vehicle production. Additionally, there appears to be a number of supply constraints, including in Chile as a result of a new, less producer- friendly, political regime. The news of Chinese property giant's Evergrande financial distress, along with increasing evidence the planet is entering a third energy crisis, has pushed this group lower yet, enhancing its long-term appeal.)
 - **A new sector recommendation is healthcare stocks. Many have corrected and are trading at alluringly attractive valuations, often with lush dividend yields.**
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- Renewable Yield Cos (Based on the hefty rally that has occurred with this group in recent months, justifying our buy rating on them earlier this year, we are downgrading them to neutral; some profit-taking is reasonable despite bright long-term prospects.)
 - A wide range of high-income securities, including preferred stocks (Preferred stocks look less attractive with prices up, yields down, and inflation risks on the rise.)
 - Intermediate-term investment-grade corporate bonds, yielding approximately 2.25% (Now rated neutral due to our increasing inflation concerns and the paucity of attractive yields.)
 - Mid-cap value
 - **Emerging stock markets; however, a number of Asian developing markets look undervalued (Caveat investor: These are much less bargain-rich than they were a year ago. China is an exception; its market has been crushed creating interesting value plays for brave investors. However, it's continuing war on its best companies is a large and legitimate concern.)**
 - US-based Real Estate Investment Trusts (REITs) (It is critical to be highly selective with this sector; however, the reopening of the US economy, despite recent challenges, should relieve pressure on some of the most impaired sub-sectors of the REIT universe—unless they are exposed to cities and/or states that are seeing significant population and business outflows.)
 - Cash
 - Canadian dollar-denominated short-term bonds (Thanks to a rebound in the Canadian dollar, these have provided solid returns this year. Recently, the loonie has weakened a bit creating a better entry point for those bond investors looking to diversify out of the US.)
 - One- to two-year Treasury notes
 - Traditionally "safe" sectors such as Staples and Utilities (Most utilities have had healthy price bumps lately; consequently, they are less appealing.)
 - Virus Victors (I.E, those companies that have benefitted from global lockdowns and now sport premium valuations. Many have retreated significantly of late; Clorox, for example, remains down materially from its peak notwithstanding the spread of the Delta variant.)
 - **Small-cap value (Moving to neutral due to high valuations and the massive appreciation since last fall; justifying our prior caution, small cap value did swoon down 10% recently before bouncing back a bit.)**

- European banks (Shifting these back to neutral due to improving vaccination prospects on the Continent. Still-prevailing negative interest rates in Europe are very hard on bank profitability.)
- Intermediate-term Treasury bonds (Moving these to Dislike due to rising risks of another price down-leg caused by the realization that after-inflation yields are becoming increasingly negative. As noted above, longer-term treasuries have been hard hit of late.)
- **Small-cap growth (Since late-February, around the time of our negative call on this style, it is down roughly 9%.)**
- As a relatively new tactical recommendation related to the above bullet, investors seeking to reduce equity exposure might want to buy an inverse small-cap ETF. One of these offers twice the upside—and downside—of the small cap index; i.e., should small caps fall 10%, this ETF will rise roughly 20% and vice versa. Thus far, this trade is approximately breakeven.
- **Long-term treasury bonds (These are in the dislike category due to both Evergreen's and Gavekal's rising conviction in a looming burst of inflation; despite a now faltering rally over the last few months, long-treasuries remain down 7.5% on a total return basis this year.)**
- **Long-term investment grade corporate bonds (These are viewed negatively because of the narrow yield gap, or spread, between corporate debt and treasuries combined with our escalating inflation fears. However, there are a smattering of long-term issues that still offer attractive yields. Long-term corporate bonds have had a negative total return of 3% for the year.)**
- Most municipal bonds (Munis have bounced a bit lately but we remain negatively disposed to longer issues.)
- **US dollar (The dollar has rallied recently, pushing it up 4 ½% for the year. This is despite the fact that the US is running a trillion-dollar trade deficit and the Fed continues to fabricate money at a \$1.5 trillion annualized rate. Thus, the dollar's long-term outlook appears very challenging and it remains overvalued versus many currencies, especially those in Asia.)**
- Many semiconductor tech stocks (We do have a number of semi holdings for Evergreen client; however, these were typically acquired far lower than where they trade today. To its credit, however, the semi index recently broke out to a new high. Despite that, its lofty valuations render it an unappealing area for new capital commitments.)
- Mid-cap growth
- Lower-rated junk bonds
- Green energy stocks (Note, this refers to equities not the Renewable Yield Cos; most of the former had explosive up-moves in 2020 and into this year; lately, though, many green energy plays have been hit hard, especially the dodgiest issues like Lordstown Motors and Nikola.)
- **SPACs (Special Purpose Acquisition Companies, which are structured to greatly favor insiders and disadvantage retail investors. The SPAC ETF has fallen 34.6% from its February highs, validating our negative stance on this highly speculative slice of the market. The *Wall Street Journal* noted recently that \$75 billion of SPAC market value has been wiped out since February.)**
- Most new issues (Earlier this year, the IPO market was as frothy as I've seen it other than the giddiest days of the dot.com era; there are also signs the new-issue craze is fading. A number of IPOs are trading below their offering prices.)
- Despite a disastrous February, most of the popular Reddit/WallStreetBets stocks still have

material downside. These meme-type stocks are sliding once again though they remain absurdly overvalued, in my view.

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