Toroso Market Commentary May 2021

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Embrace the Chaos

The results of fiscal policy are starting to come through the economist statistics, and they appear to be very strong. We are going to get some sort of infrastructure bill, and likely a less than anticipated tax increase. Now that we are a year past the initial Covid crisis and possibly halfway through our next market cycle, investors are having mixed perspectives and emotions. If you are waiting for the proverbial shoe to drop you might need to keep waiting. If you take anything away from this commentary, we hope it's this: things actually look great in the economy on a macro basis.

Potential market outcomes in the next 2 years could be anything from absolutely spectacular to a never-ending risk of disaster (potentially even a single liquidity crisis buried in the depths of some overleveraged family office). To the average investor, last year proved that the market and the economy are two very different things. Strength in one does not always carry through to the other, although we expect it will over the coming months. We are likely about to climb an insane wall of worry for the next few months, with a mounting list of concerns that could derail this.

Some investors have made more wealth in the past year than they could have ever imagined. Others have FOMO from not making more, and a whole lot were completely left on the sidelines, furthering socioeconomic inequality in our society. Even policies meant to help the masses ended up in the pockets of the few. Regardless, the money is in the system. We are left with a K shaped recovery for both companies and households, except the upper right portion of the K has gone parabolic.

TORO SO INVESTMENTS

Structural Market Thoughts

- **Trust in establishments of all kinds is eroding**. In the tech rally of the late 90's and early 2000's, we looked to our companies and institutions to provide us with guidance and protection. The government supported its constituents, the Federal Reserve protected the economy for the average American, and the news was a trusted source. We believed the government had our best interest in mind. Fast forward 20 years, and the freedom of information brought by the age of social media has ruined most trust in the establishment; enter blockchain.
- **Most market participants have figured out what the QE means for assets, and no one wants to fight the Fed anymore**. Retail is playing it in the options market. Why not bet big knowing the Fed has your back on most financial assets? Every time there is volatility, there is inevitably some portion of the Fortune 500's and the 1%'s that get even better access to credit than they did before through lower interest rates. Banks are eager to lend at unheard of rates, giving these entities and individuals ample cash to deploy right when fear and volatility peaks. It's ironic that when we spent so much time restricting which individuals and entities have access to credit in an effort to protect the "little guy," we unintentionally put that same group at a significant disadvantage when credit is most useful: in times of market volatility, not at market highs. When volatility spikes, the only loans that appear safe are those belonging to the 1% and Fortune 500. There goes another layer of the middle class. The retail mindset is to try and get there before the big money comes in. There's no bigger oligopoly in the world than the democrats and republicans in the United States, and politics and markets are as intertwined as ever, further emphasizing the case for cryptocurrencies.
- **Echo chambers are everywhere.** Almost all echo chambers believe their collective viewpoint is correct, rather than others. Most echo chambers have gained significant wealth in the past year betting on their unique perspectives. Since everything from real estate to baseball cards and dogecoin have skyrocketed, they have all somewhat been proven right. This further exacerbates their entrancement in their particular echo chamber, and causes FOMO for not capitalizing on it more. The whole world is now a stock & crypto picking savant - if you are fearful this all feels like the tech bubble, you are absolutely right; except for a few things. These growth businesses are much more real than the dot com bubble, crypto currencies are at a much different place today than 2017, and the Fed has proven to indirectly do all that it can to support asset prices.

Structural Market Thoughts (cont.)

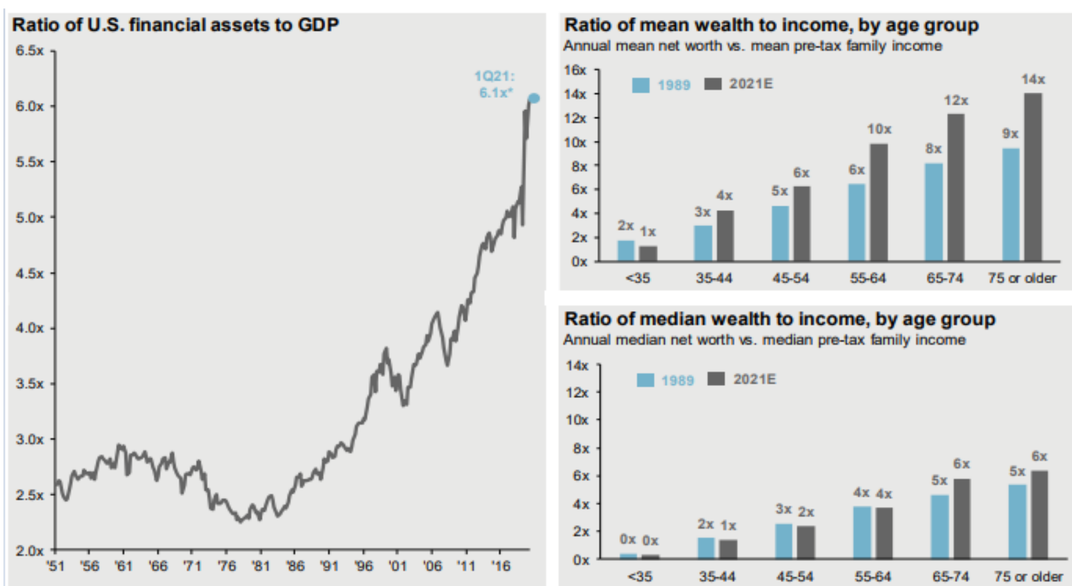
- **Story telling created a lot of multiple expansion in 2020; 2021 will be more data driven.** We've written about the book Sapiens a number of times in our commentaries over the last 2 years. This is due to the importance of storytelling in markets. Storytelling is why we felt comfortable getting aggressive in March 2020. In a world where value is attributed more and more to the potential of what a particular entity could be in the future, storytelling is more important than ever. Where would Tesla be today without Elon Musk's storytelling? In reality, Tesla's rise is really a shift in the story, from a car company to maybe the world leader in Artificial Intelligence and advanced battery storage. In 2021, tech companies have to show real growth and blow out numbers during earnings season. A lack of blow out numbers could be disastrous.
- **Battle for world power on two fronts between US vs China.** On one side you have the battle for power and control, on the other innovation and GDP, all of which are intertwined into a circular web. In the fall, there were a lot of talks about monopolistic behavior from big US tech. More recently, you have China pulling the Ant Group IPO in fear of it wreaking havoc on its bloated financial institutions. One of the biggest questions to shape markets over the next few years is how each country plans to handle their tech giants. Letting them grow to compete globally against the other's tech giants inevitably hurts most other sectors of your markets. At the end of the day, it's simple math. Our tech giants are larger, their consumer base is larger; it's inevitable that a few of theirs become larger than a few of ours.
- **Throw consumption expectations out the window for the new crypto millionaires.** There's really no way to model consumption patterns from the wealth created in the crypto space. These individuals and entities amassed this wealth by betting against the status quo and society. They likely don't have a massive 401k's, and many aren't buying insurance. They may be more drawn to cheap energy sources than they are to the status quo in major cities.
- **When will crypto come for FAANG?** It seems too early for this today, but with all of the news around Apple's app store and the fee they charge to other companies accessing their network, it's hard to believe there won't be a blockchain solution for such things one day.

Short Term Inflation Over Longer Inflationary Concerns

Everything from food to real estate, lumber, oil, semiconductor chips and your Dawn dish soap is going up in price. Hopes are that this is a short-term blip that levels out a year from now, but the potential for real inflation is here. Industrial production is lagging in part due to labor shortages, and businesses are scrambling to catch up. This may ultimately lead to overly stocked inventory in the future, but we are 6-18 months away from that being a problem.

If we truly are in the midst of multiple innovation curves across many industries, we may actually begin to grow our way out of the black hole of debt we appear to be in. This is not the most likely outcome Toroso sees, but it is a potential one. Asset prices are at such high levels that many 65+ years of age may move into retirement, which would tighten the labor force and maybe cause wage inflation for younger workers.

The ratios of mean and median wealth to income by age group, shown on the right, shows how beneficial the last 12 years (and especially the last 12 months) have been to those with financial assets. The ratio of mean wealth to income grew from 8x in 1989 to 12x today for those 65+, and for those 75+ it grew from 9x to 14x. For most, the median is more relevant than the mean, and for those 54 years of age and younger, the multiple decreased from 1989 to today. The median wealth to income ratio of someone under 45 today in American is 1x or lower. The average starts at 4x (median 1x) for that group. On average, 75+ years of age have 14x wealth to income, but the median there is just 6x, showing that inequalities in wealth exist at all ages in our country.



Sources: Bureau of Economic Analysis, Federal Reserve, J.P. Morgan Asset Management. *1Q21 estimates are from J.P. Morgan Asset Management. U.S. financial assets includes U.S. financial assets held by rest of world and excludes rest of world assets held by U.S. entities. Forecasts, projections and other forward looking statements are based upon current beliefs and expectations. They are for illustrative purposes only and serve as an indication of what may occur. Given the inherent uncertainties and risks associated with forecasts, projections or other forward statements, actual events, results or performance may differ materially from those reflected or contemplated.
Guide to the Markets – U.S. Data are as of March 31, 2021.

Market Risks and Rewards

It is far from guaranteed, and seemingly less likely each week that we will reach herd immunity from Covid, with new strains popping up in various parts of the world. Does this cause another exodus from cities? Does it even really matter for markets and the economy? Maybe just for our collective sanity. The amount of hidden leverage in the system is massive, creative, complex and, quite frankly, not really fully understood by any one group. Consumer Confidence & the use of leverage has soared – typically a bad time for risk assets with a less friendly Fed.

With the bad, there is also plenty of good. Retails sales increased 9.8% in March month over month. The Federal Reserve Money Supply M2 is up 25% year over year (descending from a peak of 27%), and innovation is occurring across pretty much every industry, despite being led by just a few.

Overall, not much has changed in our approach. We successfully rotated into more reopening & value trades over the last few months to barbell our growth names, but in general, the approach remains the same. High active share is king, and within that, diversify, diversify, diversify. Bet big on high growth and value, allocate heavily to alternatives, rebalance without emotion and expect pockets of volatility. With the amount of leverage in the system today, the days of 5-15% corrections are in the past; they will be of higher magnitude in the future.

Perhaps the single biggest risk to markets is also the asset class we are most bullish on long term: cryptocurrencies. Dogecoin smells too much like pets.com, and if all growth assets are to be correlated, it makes sense that the Federal Reserve will not protect the asset that leads to the next liquidity crisis. Bitcoin could very easily be at $150k before this happens, or it could begin tomorrow.

US Equities

Zombie companies still exist out there, and many are being bid up in the recent rotation to Value. Much of the Russell 2000 exists without profits. Broad indexes should still be invested in with caution. One big difference between truly high growth areas and value is that 6 months of no price appreciation means two very different things. One has low single digit growth rates while the other can exist in the mid-teens. 6 months without price appreciation in Growth markets may result in a 10% decline in current fundamentals. While financials and energy have been on a tear, a continued rally in all things commodities is unlikely. Materials for chips and houses aside, with the growth in electric vehicles and alternative energy, each new peak in Oil prices is likely to be lower than the last, leaving much more downside than upside for crude. Overall, the S&P 500, led by the iShares S&P 500 ETF (IVV), returned 11.83% as of April 30th. Large cap value is 5% ahead of large cap growth, and small cap is beating all, up 20.4% through April. Value has outperformed momentum by almost 14% this year. We recommend high active share in both Growth and Value areas.

Broad	Narrow
• None	• Davis Select US (DUSA) • SPDR S&P Kensho New Economies Composite (KOMP) • Ballast Small/Mid Cap ETF (MGMT)

International Developed & Emerging Markets

MSCI ACWI ex US, measured by the iShares MSCI ACWI ex US ETF (ACWX), was up 6.48% through April. iShares MSCI EAFE ETF (EFA) was up just 6.62%, while the iShares MSCI EM ETF (EEM) was up just 4.56%. International developed equities are the value play of all value plays, or a perpetual value trap lead by an unhealthy banking system hooked on the ECB. They are definitely further behind the US in its vaccination rollout. Emerging Markets as a whole, similar to Europe and the US, are full of zombie companies. Despite this, there is still massive potential in the tech / Internet of Things space that is primarily coming from the Emerging Markets and China.

Broad	Narrow
• WisdomTree EM ex-SOE (XSOE)	• Davis Select International (DINT) • Emerging Markets Internet & Ecommerce (EMQQ)

Fixed Income

As we mentioned in previous commentaries, the Federal Reserve officially became co-investors in the bond side of a 60/40 portfolio in 2020 (the equity side may come in future market disruptions a la Japan). The Fed stepped in and bought shares of iShares iBoxx $ Investment Grade Corporate Bond ETF (LQD) and iShares iBoxx $ High Yield Corporate Bond ETF (HYG), and US bond markets may never be the same again. iShares Core US Aggregate Bond ETF (AGG) is off to a terrible start, returning -2.63% for the year through April. Long-term treasuries measured by the iShares 20+ Year Treasury Bond ETF (TLT) returned -11.89%. Yields on treasuries may have topped out for the year, but we still wouldn't get too aggressive on the lower credit side of the spectrum. What's very interesting is the breakdown in strong negative correlation between Momentum / QQQ and treasuries that we saw last year, with inflation expectations rising. The Fed has stated that interest rates will remain low for years. We see a risk that the Fed will need to step in sooner than anticipated and raise interest rates, which is far from a major 2022 concern. Active is preferred here as well; broad indexes are highly weighted in debt, rated just above default, which will be a problem if the Fed-induced merry-go-round even shows slight signs of stalling.

- PIMCO 25+ Year Zero Coupon US Treasury (ZROZ)
- SPDR DoubleLine Total ReturnTactical (TOTL)
- First Trust TCW Opportunistic (FIXD)
- Quadratic Interest Rate Volatility and Inflation Hedge ETF (IVOL)
- Saba Closed-End Funds ETF (CEFS)
- VanEck Vectors CEF Municipal Income ETF (XMPT)

Alternatives

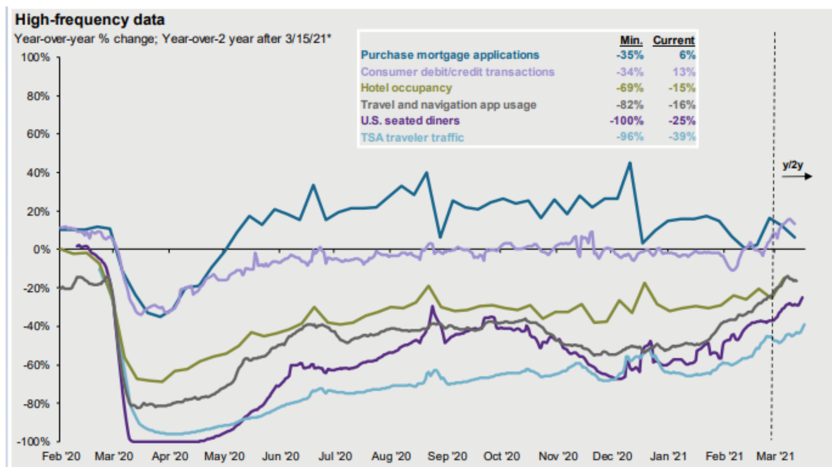
It's been a painful year for all things alternative. Gold, measured by SPDR Gold Shares ETF (GLD), was down -6.65% for the year, as were treasuries. The dollar is up just slightly on the year and commodities, measured by the Invesco DB Commodity Index Tracking ETF (DBC) is up 22.16%. We can make a case for a run in precious and industrial metal, all things tied to semiconductor chips, and potentially even see lumber at elevated levels persisting, but the oil run has likely dissipated.

A hypothetical high-active-share reconstruction of a traditional 60/40:

- 5% Quadratic Interest Rate Volatility and Inflation Hedge ETF (IVOL)
- 5% PIMCO 25+ Year Zero Coupon US Treasury Index ETF (ZROZ)
- 10% Saba Closed-End Funds ETF (CEFS)
- 5% AGFiQ US Market Neutral Anti-Beta (BTAL)
- 10% SPDR Gold MiniShares Trust (GLDM)
- 10% SPDR S&P Kensho New Economies Comps (KOMP)
- 10% Davis Select Worldwide ETF (DWLD)
- 10% Emerging Markets Internet & Ecommerce (EMQQ)
- 10% Ballast Small / Mid Cap ETF (MGMT)
- 10% Amplify Transformational Data Sharing ETF (BLOK)
- 10% Sofi Gig Economy ETF (GIGE)
- 5% Distillate US Fundamental Stability & Value ETF (DSTL)

Conclusion

There truly is a lot of data pointing to a strong reopening. What will be interesting to see is whether people's desire to increase spending on everything from services to leisure will lessen some of the retail influence the market experienced while we were all stuck at home. Everything from travel to dinners, hotel occupancy, and mortgage applications are on the rise. Invest cautiously, though it look like we are headed for record earnings on the S&P 500 in 2021.



Source: App Annie, Chase, Mortgage Bankers Association (MBA), OpenTable, STR, Transportation Security Administration (TSA), J.P. Morgan Asset Management. *Beginning March 15, 2021, all indicators compare 2021 to 2019. Prior to March 15, 2021, figures are year-over-year. Consumer debit/credit transactions, U.S. seated diners and TSA traveler traffic are 7-day moving averages. App Annie data is compared to 2019 average and includes over 600 travel and navigation apps globally, including Google Maps, Uber, Airbnb and Booking.com. Consumer spending: This report uses rigorous security protocols for selected data sourced from Chase credit and debit card transactions to ensure all information is kept confidential and secure. All selected data is highly aggregated and all unique identifiable information—including names, account numbers, addresses, dates of birth and Social Security Numbers—is removed from the data before the report's author receives it.
Guide to the Markets – U.S. Data are as of March 31, 2021.