Our team adheres to a set of principles designed to provide an exemplary client experience

• We believe the trust of our clients is earned over time and remains our most important asset.
• We take great pride in the professional quality of our work. Exceptional client service that is proactive, thoughtful, and customized.
• Competitive investment returns with a focus on risk management.
• Sophisticated financial planning—an essential pillar in the development of your customized investment strategy.
• We believe in continuous improvement. As our clients’ needs change, we learn and adapt.
• We stress teamwork in everything we do and remain accountable for our responsibilities.
• Integrity and honesty are at the heart of our business. Integrity—we do what we say we're going to do, full disclosure and no surprises. Honesty means we give it to you straight, even if it means having a difficult conversation.
• We regularly receive confidential information as part of our normal client relationship. It is our responsibility to protect against the unauthorized disclosure of this information.

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IS THE CURRENT MARKET A BATTLE BETWEEN THE FED AND THE FUNDAMENTALS

Human beings want to feel that they are on a power walk into the future, when in fact we are always just tapping our canes on the pavement in the fog.

Howard Marks
Oaktree Capital
May 27, 2020

It has been a little more than a month since I have written my last letter, If It Weren't Real It Would Have To Be Fiction. I try and write these notes when I feel that there is something of substance to write about based on general observations I have made on the markets. Taking a step back, the markets topped out in late February, bottomed (at least so far) in late March, and have rather consistently rallied since then. The markets actually rallied through some pretty substantial overhead resistance this past week and as such I felt it was important to reflect on the environment, what we have been dealing with, and what we theoretically could expect going forward.

From a general perspective, it appears that we have been living through an incredibly large tug-o-war between the Fed and some of the worst fundamentals imaginable. The post Covid-19 future doesn't exist yet, to be honest, even though things seem to be new every day. It will exist only after we have made it out the tail end. I think this is a very important concept. We might predict the future today, and we might even correctly assess what today's conditions and actions are likely to produce in the future. But that prediction will be shown to have been right only if no one and nothing causes the future to become different between now and the day it arrives. Yet I recognize that not only is my opinion on that topic of little value, but I also don't have the expertise required to know for sure whose opinion does count. What I do know is that the last thing I should do is choose an expert because his or her opinions agree with mine and allow confirmation bias to affect my decisions.

At present, we seem to be witnessing a battle between a huge amount of money being pushed into our financial system in a variety of different ways and some of the worst fundamentals imaginable; a virus with an immeasurable level of effect on human life, economic strife the likes of which that has never before been seen shy of the nightmare of the twin towers, the consequential effect on mass and immediate closure of businesses and ensuing unemployment, and just when we think we have seen enough unprecedented shocks we are hit with another Mike Tyson style left hook; riots due to the brutal death of a man in Minneapolis. So, what is an investor to do!!!??? This is where I believe that individual market, sector and company analysis needs to be focused upon while at the same time being hypersensitive to these negatives and how they are to be quantified, in the future, could be enough to change the directions of the market. Seems like a perfect setup for a disaster yet the markets keep moving back up in an almost V shaped recovery that puzzlingly seems to be ignoring this compendium of disasters.

I believe that the problems that we are being faced with have been an unexpected and immeasurable catalyst to stratospheric growth in technology and specifically software cloud. The chairman of Microsoft, Satya Nadella, was quoted as saying on his earnings
call, “We’ve seen two years’ worth of digital transformation in two months. From remote teamwork and learning, to sales and customer service, to critical cloud infrastructure and security— we are working alongside customers every day to help them adapt and stay open for business in a world of remote everything.”

I found this to be the clearest comment I have seen from the biggest software CEO currently on the planet. The technology world had incredibly valuable advances in 2000 yet the world had not arrived at a place to take advantage of all the different and new technologies that were being represented by never before seen companies that were going public with few employees, nascent products, no assets and nothing really but a bunch of promises about how they could change the world. Fast forward to 2020. We started the year with numerous companies that had begun to develop following for their products and all of the sudden whom! Covid-19, business closures, and layoffs. This has panned out to be a perfect backdrop for software, cloud, online retail, food delivery and many other industries to go from 25 miles an hour to 100 miles an hour almost immediately. Where we go next is very difficult to quantify other than if the Fed continues to fuel almost all engines with massive amounts of capital, and inflation doesn’t seem to raise its ugly head, this advance could continue. Fed Chairman Powell stated in the first week of May that the second quarter may end up being the absolute worst economic quarter the United States has experienced in its history and he warned that the Fed won’t be able to save the economy by itself. He did say they’d do everything in their power to support it, but that eventually the economy will have to work itself once again. So, when you combine that economic and fundamental backdrop with the major technical resistance that market has faced recently, I have thought it prudent to remain more short term in my analysis of companies and the markets in general.

This brings me to my next point. If we could possibly put the Fed and the fundamentals aside for a moment, where are we currently? From a different perspective (other than focusing on the ills of the current economic slowdown) we are now in an every four year environment, that of an election year, the month of May, and what to expect going into the next great unknown, the elections in November. Our Chief Technical Strategist, Ari Wald put out the following chart to give a graphic picture of what normally occurs:

![Investors should prepare for a barrage of “sell in May, and go away” financial news articles this week, and we admit it’s been sound advice if an investor followed it without question for the last 70 years. Since 1950, the S&P 500 has averaged a mere 1.1% gain between the months of May and October vs. a 6.6% gain between November and April. However, these seasonal headwinds are balanced when we overlay the four year US Presidential cycle during election years with an incumbent candidate (e.g., 2020). May weakness has historically been bought ahead of a summer-time rally between June and August, by our analysts. Overall, we see positive based on our market recovery scenario, and believe the seasonal backdrop suggests any weakness in May should be bought.](image)

![S&P 500 Average Return (1950-2020)](image)

To me, it is clear that the calendar forecasts a good picture for the markets. Will this be the case? It would be my hopes that it proves to be true, but it is far from me to expect that;

- The economies of the world will open.
- People will become reemployed.
- Consumption will expand.
- Small and medium sized business will go back to business as usual and pay their lease payments.
- Covid-19 deaths will not only drop quickly but also doesn’t raise its ugly head again for a second wave.

Stranger things have happened! This brings me to a rather small article from May 11, 2020, Barron’s, written by Matthew C. Klein, titled, “Laid-Off Workers Show Confidence They’ll Be Rehired.” His opening statement was, “85% of California employees expect to get their old jobs back after the crisis.” I implore you to Google this article and read it. It is very short, but a far cry from all of the ugly comments that are being espoused ad nauseum in the press. In the end, we have been in a bull market since the beginning of 2009. According to Jeff Saut, of Saut Strategy, most secular bull markets tend to last 15-20 years and are not stopped by 30%+ declines. If this is true we have further to run. Why? That will be one for the history books. But, suffice it to say that there are some industries that will benefit and have had their growth rates catalyzed higher by virtue of the environment we are in. These are the industries that we will continue to focus on while at all times looking for changes that will cause us to change.

Enjoy summer 2020. Hopefully things will mellow a bit and give us a chance to meet with friends, get our hair done and even go out to dinner! Stay tuned! It will certainly be entertaining and if observed properly, profitable!

Very truly yours,
The South Group

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