MONTHLY NEWSLETTER

Market Report – Titan Investment Management LLC

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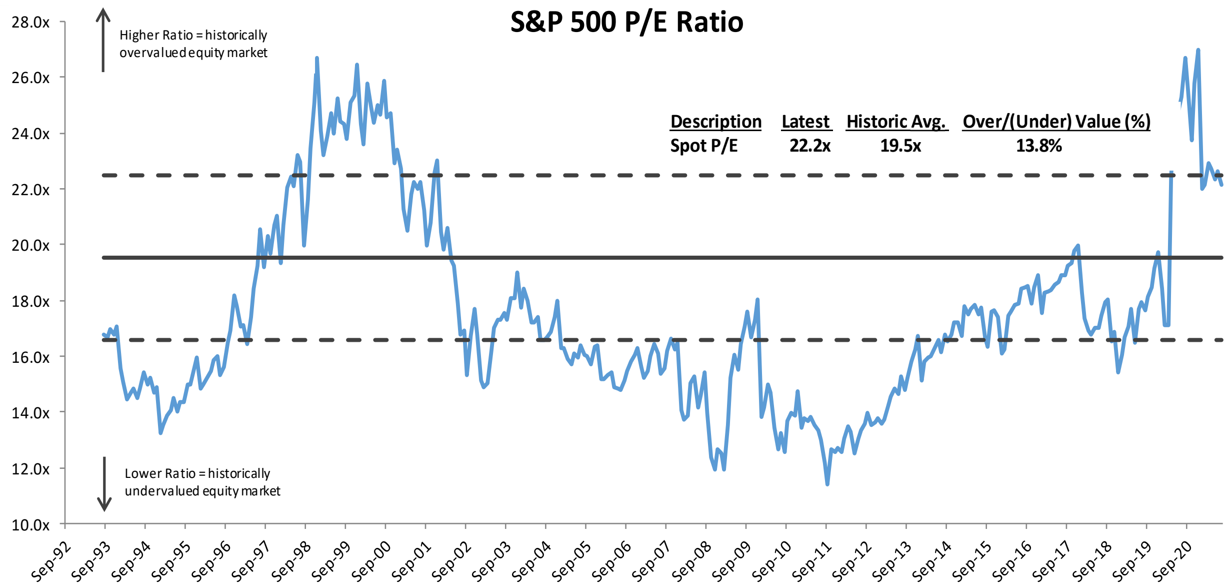
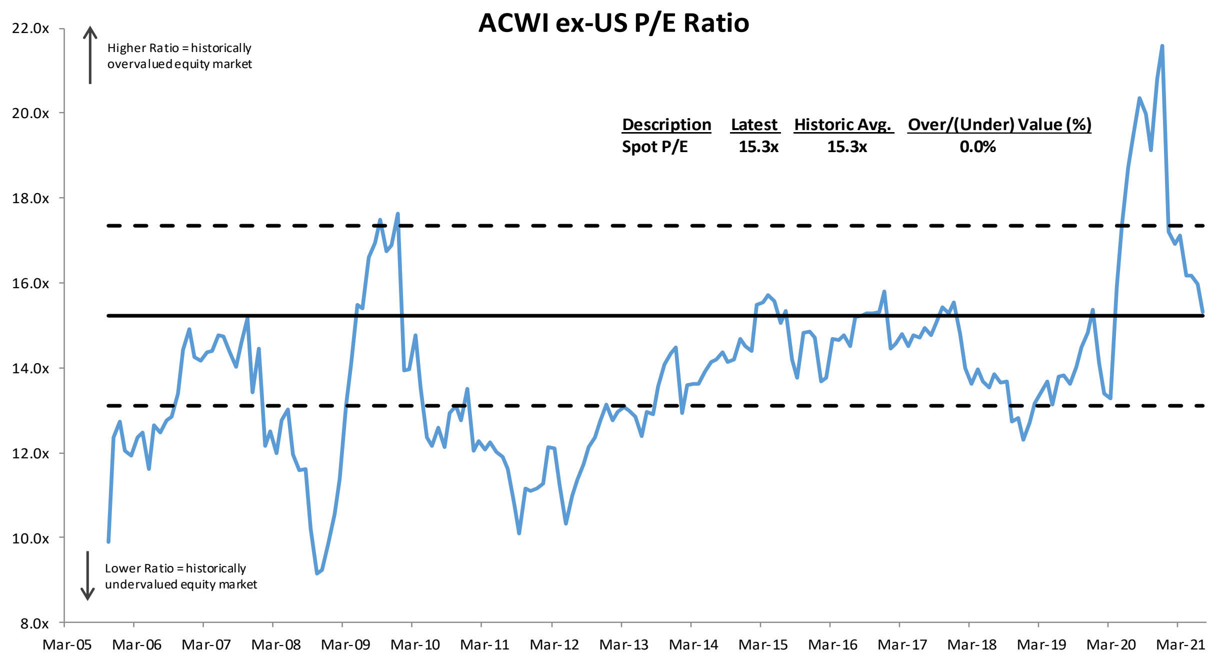
Equity Fundamentals and Earnings Season:

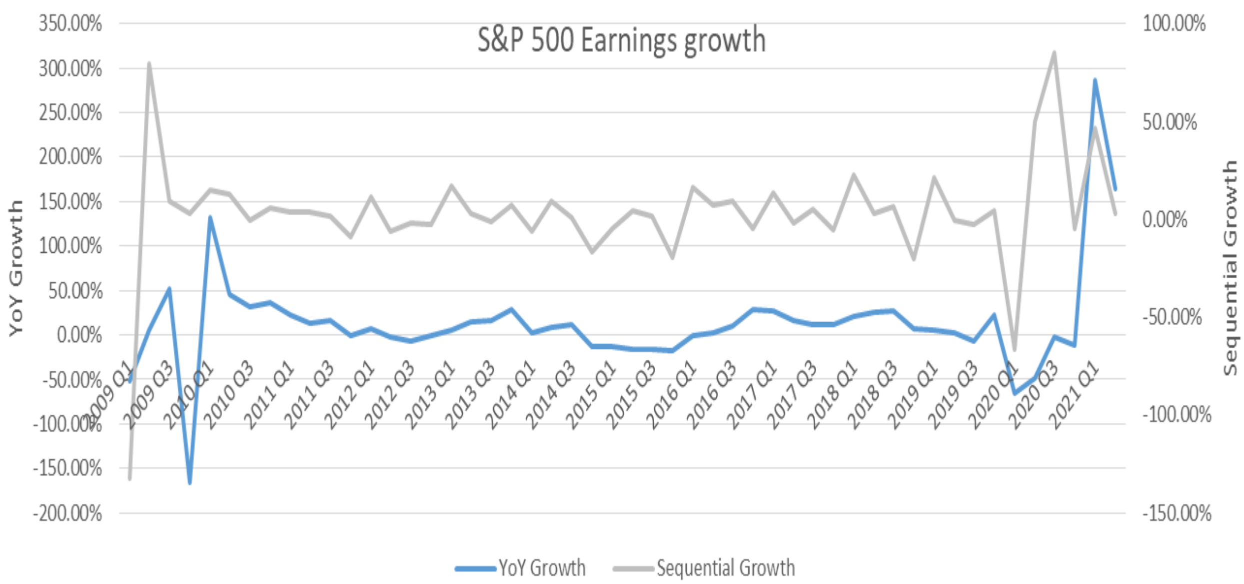




Earnings have been absolutely fantastic during the Q2, registering a growth rate of 165.0% with 59% of S&P 500 firms reporting. If this growth rate holds it will be the highest YoY growth rate since the turn of the century. In addition, the estimated growth rate for Q2 was 63.1%, highlighting that reality is blowing away expectation.

What will ultimately drive P/E ratios lower and the stock market higher is continued growth in earnings. Fortunately when taking into account the historic growth of earnings from both a year over year and sequential perspective the outlook is bright.

	Medians			
	1YR	3YR	5YR	10YR
YoY Growth	80.99%	4.32%	11.82%	6.74%
Sequential Growth	24.48%	3.67%	3.83%	2.26%



Starting with sequential growth as it tends to wash out the effects of volatile events such as COVID, the median sequential growth rate hovers around 3.75%. Taking 1Q21 earnings of $45.95 and extrapolating out Q2, Q3, and Q4 yields annual earnings of $194.39 or a P/E of 22.8x. 22.8x is above the historic average of 19.5x, but it is important to remember the price today is a reflection of tomorrow. In other words, the most recent earnings reported ($45.95) needs to be extrapolated out a year.

	2021-22	2022-23	2023-24
Projected EPS	$201.69	$233.69	$270.76
Forward P/E	$21.96	$18.96	$16.36

Thus, projecting out earnings 1 year yields a P/E multiple of 22.0x. In addition, two years from now this ratio drops to 19.0x (below historic averages). It needs to be noted that this table comes with the assumption that the S&P 500 does not change. However, if earnings are $233.69 a year from now and the S&P 500 maintains its current level of 22.2x implies market appreciation of 17.1%. This hammers home the fundamental point that the recent earnings growth of the S&P 500 coupled with the historic median growth rate yields a robust outlook.

Moving onto year over year (YoY) growth can be fairly messy. For example, YoY growth over the past 12 months has a median level of 81.0%. This is obviously being motivated by the low base set in 2020 from COVID. However, applying a more historic norm of 7.5% YoY growth yields the following projection.

	2021-22	2022-23	2023-24
Projected EPS	$176.11	$235.19	$314.09
Forward P/E	$25.15	$18.84	$14.10

The results 1 year from now are not as good as sequential, but three years from now are much more robust. This stems from a historic growth rate of 7.5% being applied to an abnormally low Q3 and Q4 in 2020 stemming from COVID. Overall, the projection is not much different from sequential growth as earnings are projected to be $235.19 a year from now. This implies market appreciation of 17.9%.

Whether one views growth sequentially or YoY yields a bright outlook for the market in general. Naturally, the next question to ask is whether this growth is evenly distributed across the economy or concentrated in certain sectors. Insight into this question can be captured by the most recent earnings reported at the sector level and comparing those to the same quarter of 2019.

	2021E Q2 Growth
S&P 500	**16.29%**
S&P 500 Consumer Discretionary	-4.83%
S&P 500 Consumer Staples	38.92%
S&P 500 Energy	21.23%
S&P 500 Financials	18.27%
S&P 500 Health Care	7.19%
S&P 500 Industrials	11.87%
S&P 500 Information Technology	21.51%
S&P 500 Materials	72.59%
S&P 500 Communication Services	23.95%
S&P 500 Utilities	1.50%
S&P 500 Real Estate	-0.24%

The pantry stockpiling that has taken place as well as demand for metals has pushed Consumer Staples and Materials higher. On the other hand, the closure of store fronts on COVID fears has not only hurt Consumer Discretionary, but Real Estate as well. This is not completely surprising, but more importantly provides evidence of those sectors that not only provide insulation from COVID, but also exposure to growth in a reopening economy.

Overall this is one of the fundamental reasons that Titan Investments will continue to overweight Information Technology. This industry is incredibly profitable, but has shown its resilience in the face of COVID, variants, hotspots, and all things pandemic related.

<u>COVID and Endemic Fears</u>

Anthony Fauci, Staphane Bancel (CEO of Moderna), and Mike Ryan (Executive Director of WHO) have all chimed in that the coronavirus may never go away. This stems from the recent outbreak of the Delta variant and the fear that variants will continue to arise thereby calling for vaccine boosters and a never-ending battle.

Rather than focus on the sensationalism of news and the headlines that are meant to be clicked rather than disseminate factual information, certain questions need to be answered. In addition, how these questions will influence the market.

1) *How many people have been infected with COVID?*

Total Coronavirus Cases in the United States

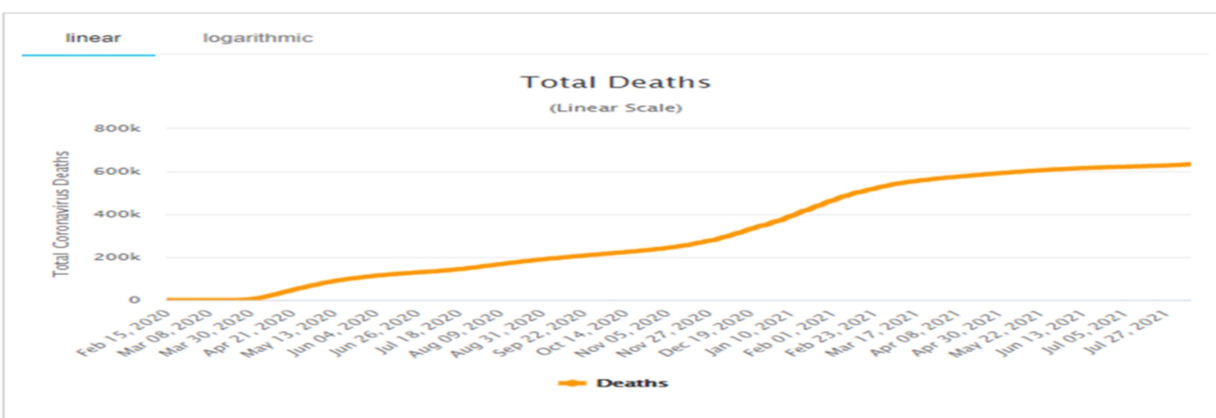
The US is close to a reported 37M cases since the inception of COVID. There are ~328M people in the US and this implies an 11.3% infection rate. However, this does not take into account people who used at home tests, asymptomatic cases, unreported symptomatic cases, and/or repeat cases. Thus, it seems fair to assume that the actual number of COVID cases is significantly more than 37M.

The UT Southwestern Medical Center used machine learning to create an algorithm that seeks to measure the true number of infections. Using a host of variables, with an increased focus on COVID deaths estimates that nearly 100M Americans (30.5% infection rate) have caught COVID. The study lacks the data to distinguish between Novel and Delta infections, but the overall number of infections is much more realistic when considering the lack of reporting and the range cited of 175M to 37M.

This serves as statistical evidence a large portions of Americans have caught and will most likely catch COVID as Delta ramps up regardless of vaccine (more to come). While this may seem scary at first the sheer increase in number of infections reduces the deadliness of the disease (deaths/infections). In addition, the fear of COVID will dilute over time as it unfortunately becomes a part of life. This is a net positive from the market's point of view as each variation and/or hotspot will become less and less important from an economical point of view.

2) *How many people have died from COVID?*

Total Coronavirus Deaths in the United States



Over 633K Americans have died from COVID since inception. Projecting the number of cases yields a fatality rate ranging from 0.36% to 1.71%. Given the overall lack of reporting of infections, the fatality rate is most likely closer to 0.36%. With little context 0.36% (or 633K) may sound like a lot or a little pending on the reader. However, consider the list of deaths/year from the following ailments:

a. Heart Disease – 635K
b. Cancer – 598K
c. Accidents – 161K
d. Respiratory Disease (ex-COVID) – 155K
e. Stroke – 142K

This list comes directly from the CDC and provides unique insights into how Americans react to life threatening ailments. For example, Heart Disease and Cancer result in more death/year than the 633K COVID deaths since inception. However, Americans are not forced to drink more water and/or go for a daily walk. Meanwhile, schools are forcing masks, employers are forcing vaccinations, and politicians are threatening to withhold state funding. This trend in overall healthcare shines a spotlight on American complacency. We as Americans have digested these ailments as just a part of life despite the amount of death these ailments have left in their wake. Thus, COVID is on a similar path where hotspots and variants fall further down the Google search results.

Another interesting point to consider around viruses and mutations is the very nature of evolution. Viruses like people do not want to die and a virus that results in the host dying results in the virus dying. A host of historic respiratory viruses such as the H1N1 Influenza, Spanish Flu, Swine Flu (2009), and Myxoma have all been viruses that were very transmissible and deadly at inception, but mutated to be less deadly overtime, allowing the virus to survive. Early evidence indicates that is exactly what Delta is doing by being more transmissible, resistant to vaccines, but less deadly. Thus, the real underlying risk that needs to be followed is not cases, deaths, and/or vaccinated, but instead hospital capacity.

Economically, this will need to be watched closely as hospitals being overwhelmed is grounds for another shutdown. This is especially the case as nurses and doctors coast to coast feel the burn out of COVID and the overall occupation. Any sort of healthcare capacity fears will be grounds to take proactive steps to avoid cyclical industries.

3. How effective is the vaccine?

Originally the Pfizer vaccine was 95% effective at stopping COVID. However, this study was conducted a year ago without the presence of Delta. On July 21, The New England Journal of Medicine published that the Pfizer vaccine was 88% effective against Delta (~19,000 sample size). Given that Delta is so new, more robust studies on the variant are still being completed, but early results show that Johnson & Johnson is 67% effective, Moderna is 72-95% effective, and Pfizer is 64-96% effective.

The most concerning study was done by the Center for Disease Control (CDC) in the state of Massachusetts that found infections rose from 0 to 469 over the month of July. Of the 469 cases, 346 (74%) had been fully vaccinated and nearly 80% of those were showing symptoms. Lastly, the viral load for both unvaccinated and vaccinated was the same. This provides real world data that not only contradicts the studies done by pharmaceutical firms, but evidence that both the vaccinated and unvaccinated are spreading the variant.

While the effectiveness of the vaccine against transmitting Delta is clearly losing ground, the vaccine does appear to be effective at preventing hospitalization. A host of unpublished studies around the world indicate that while the vaccine does not prevent transmission it does prevent hospitalization. This is an overall net positive for those who wish to be vaccinated to get vaccinated. Not only does it help prevent hospitalization, but will also help prevent hospitals and the economy from being overwhelmed.

4. What does this mean for the market?

The panic that ensued from COVID-19 resulted in one of the fastest drawdowns in equity markets going back to the Great Depression. The S&P 500 fell 34% while interest rates fell over a percent in a matter of a month. To put this in perspective, the 2008 Great Recession saw the S&P fall 50% while interest rates fell 2.75% over 18 months.

The ensuing rally that took place in equity markets saw the S&P 500 return to its pre-COVID high by August as infections fell and vaccine progress was made. One of the largest unknowns for the future is Delta and the eventual variations that will come and go. Fortunately, the overall narrative stemming from Delta is moving in the right direction from the market perspective. This direction is a result of the following factors:

a. The economy as well as society has been through this and now have a more realistic expectation of what to do around social distancing, masks, and overall hygiene.
b. Over 50% of Americans have been vaccinated, which at the very least has shown to prevent symptoms and hospitalization.
    i. Despite all vaccines showing signs of waning protection after 6 months, a booster timeline is in place for those wanting to be vaccinated.
c. Despite the recent increase in infections in the US of 480% (7-day average of 20,010 increasing to 116,503) deaths have only increased 108% (7-day average of 243 increasing to 506).
d. Children (<17 years of age) have been incredibly resilient against COVID.
e. The true number of COVID cases is significantly higher than has been self-reported. This leads to an understatement of people who have natural antibodies.

Putting this all together yields an endemic environment where COVID-19 will not be going away. Investment wise, COVID-19 will serve as a perpetual headwind from the economy realizing its full potential. Both now as well as historically this headwind is best combated by Technology and Healthcare. This along with the strong underlying fundamentals of each industry is why Titan Investments will remain overweighting these sectors.

Conclusion:

COVID-19 is an endemic that the world will have to learn how to incorporate into everyday life. Fortunately from a market perspective, firms across the board have proven to be incredibly resilient growing earnings 165%, well above their pre-COVID levels. Earnings growth is showing little signs of slowing and setting the stage for broad market appreciation across the US.

In the short term the possibility of infrastructure spending and positive sentiment that the economy will reopen may push cyclical industries higher. However, these industries that thrive on macroeconomic sentiment show little value to sectors such as Technology. Technology not only grew during COVID, but before and after highlighting the perpetual demand for Technology at home as well as at the office.

Titan Investments is taking the step to overweight Technology for the robustness in earnings as well as lack of exposure to raw materials. Whether the infrastructure bill passes the House of Representatives will have little effect on Technology as it is not dependent on spending by the government.

If you have any questions, please do not hesitate to ask.

Respectfully

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