STRATEGAS

insight

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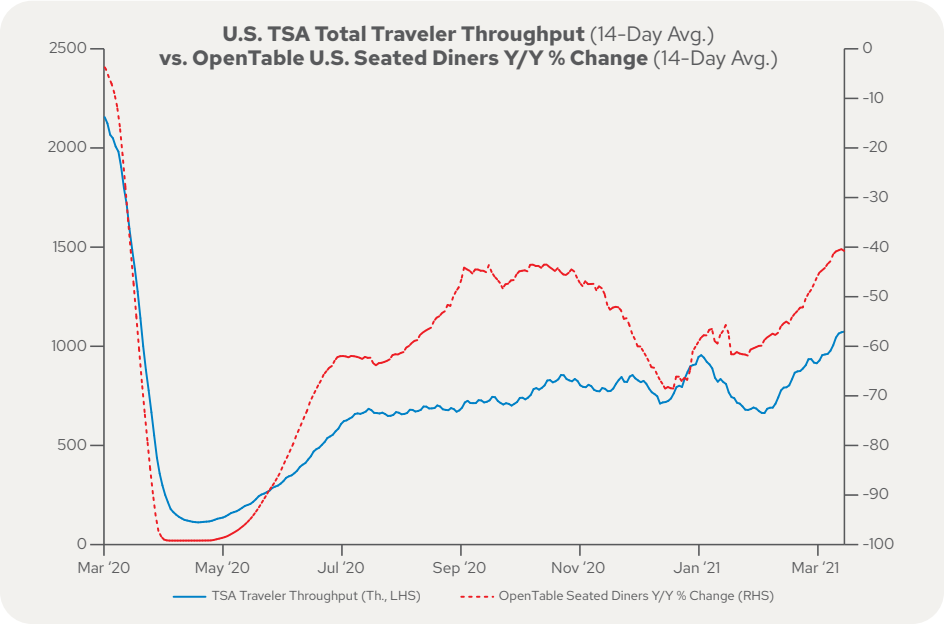
Bullish. Why the Long Face?

In 2000-2001 (technology) and 2007-2008 (housing), the excessive and speculative allocation of capital—*directed almost exclusively toward a small clutch of hyper-growth market segments*—resulted in providing an oversupply of incrementally subcaliber goods and services to markets increasingly approaching saturation. The resulting disequilibrium was sufficient, in both cases, to curb not only speculative excess in the extended investment sectors but to trigger a broad market sell-off and an economic contraction. In turn, each crisis was followed by a long period of fundamental repair (and institutional indifference) for the industry at the scene of the accident.

That is not what happened this time.

A year ago, the entire world faced off with an acute medical problem (to put it mildly) that required (said simply) a medical solution. Although the onset of the global pandemic caused a wild period of panic selling and institutional deleveraging, the aggressive program of fiscal and monetary stimulus global policymakers have undertaken clearly has helped to bridge the gap between those two points—*the virus* and *the vaccine*. Graphed onto the traditional scaffolding of cyclical recovery has presented investors with an economic muscle on steroids. With extraordinary fiscal and monetary stimulus revving the engine for corporate investment and retail consumption, the presentation of a recovery catalyst—*in this case, the re-opening of the economy*—should lead, in succession, to an exaggerated increase in activity, demand, output, revenue, investment, and profitability. **Bullish.**

Aggregate revenues for the S&P 500 Index are expected to increase as much as 11% Y/Y for calendar year 2021, and corporate profits may rebound as much as 30% Y/Y. Given the considerable progress that has been made in administering the vaccine, the combination of an additional $1.9 trillion of fiscal stimulus and $1.3 trillion Y/Y of incremental household savings being injected into the US economy should condition investors for "right-tailed" outcomes. Said simply, the data could be stronger.



Accordingly, Strategas Asset Management maintains an above-benchmark 67% exposure to equities in our tactical allocation portfolios, relative to the traditional 60%/40% framework. More granularly, within global equities we favor US all cap value, US small caps, and international shares, specifically commodity-exporting emerging markets countries. From a US equity sector perspective, we believe traditional cyclical sectors will continue to benefit from the recovery in US economic growth. We are overweight Financials, Industrials, Energy, and Materials. We remain generally underweight to fixed income, with 27% gross exposure versus 40% for the benchmark.

Strategas Recommended Asset Allocation (Mar'21)		
	Equities	Bonds
Overweight	US LC Value EM AC Core US MC Value US SC Core	IG Corporates
Neutral	Dev AC Core US LC Growth US MC Growth	ABS/CMBS Agencies TIPS Bank Loans US Dollar EMD
Underweight	US LC Core US MC Core	US MBS U.S. Treasuries High Yield

So why the long face?

How long will this robust set of circumstances last? It seems little impetus exists on the part of policymakers to curtail—*what increasingly could be viewed as*—profligate fiscal spending. The insistence on "more" spending to fill economic potholes (both actual and imagined) carries the real potential (in our view) of creating a similar environment of fiscal resource misallocation to what was seen in the 1930s and the 1970s. Making this more troubling is the Federal Reserve's seemingly casual indifference toward combating the concomitant effects of rising inflation. Consider the recent $1.9 trillion fiscal stimulus package. Most of the money (~$1.2 trillion) will be distributed into the economy in the current federal fiscal year (ending Sept. 30), with another ~$400 billion working through in FY2022 (October 1–September 30, 2022). And the bond market's response? U.S. Treasury bonds have been sold hard year to date. The yield on the 10-year U.S. Treasury Bond has moved from 0.92% at the start of the year to ~1.75% as of this writing.

Now envision a scenario in which the Administration proposes a $2 trillion+ federal infrastructure bill. Sounds good, but given the current political climate and the available legislative levers, congressional Democrats most likely must use the same reconciliation process they used for the March 2021 $1.9 trillion stimulus to put the new bill on the President's desk. This likely will result in the inclusion of "revenue raisers," i.e., higher taxes. Infrastructure spending takes longer to work through the economy. The American Jobs Creation Act, passed in the early days of the Obama Administration, was championed as an investment in "shovel ready" public works projects. In reality, the bulk of the federal distribution did not begin until the fifth quarter after the bill passed (or 2Q2010). The offsetting tax provisions necessary to pass President Biden's infrastructure plan would likely take effect immediately. The result? The potential for net fiscal drag in FY2022-2023. Capital markets participants will not let this sneak by unnoticed. Policy uncertainty makes them nervous.

To address this, Strategas recently revised our calendar year 2020 estimate for S&P 500 Index EPS to $184.50, a good $11 above consensus, with line-of-sight to $197.25 for calendar year 2022 earnings. The 2022 estimate of $197.25 is below the Street's prevailing ~$199 estimate for the same period. We will keep our eyes on inflation and interest rates to see when and where the winds shift from tailwind to headwind. The potential for a powerful reopening of the economy in 2021 could mask the reckoning in the not-too-distant future. We hope we are wrong.

About Strategas

Strategas is a global institutional brokerage and advisory firm. The Firm provides macro research, capital market and corporate advisory services, and investment management solutions to institutional investors and corporate executives in more than twenty countries around the world.

Founded in 2006 by Jason DeSena Trennert, Nicholas Bohnsack, and Don Rissmiller, the Firm was acquired by Baird Financial Group in 2018. Strategas operates independently as a wholly-owned subsidiary of Baird and offers institutional securities services through Strategas Securities, LLC, a broker-dealer, and investment management solutions, including this commentary, through Strategas Asset Management, LLC, a registered investment advisor.

About Envestnet

Envestnet, Inc. (NYSE: ENV) is transforming the way financial advice and wellness are delivered. Our mission is to empower advisors and financial service providers with innovative technology, solutions, and intelligence to make financial wellness a reality for everyone. Over 106,000 advisors and more than 5,100 companies including: 17 of the 20 largest U.S. banks, 47 of the 50 largest wealth management and brokerage firms, over 500 of the largest RIAs and hundreds of FinTech companies, leverage Envestnet technology and services that help drive better outcomes for enterprises, advisors and their clients.

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Index Overview & Key Definitions

Fed, The Fed or FED refers to the Federal Reserve System, the central bank of the United States. Fed Funds Rate, the interest rate at which a depository institution lends funds maintained at the Federal Reserve to another depository institution overnight. The Gross Domestic Product (GDP) rate is a measurement of the output of goods and services produced by labor and property located in the United States. Real Gross Domestic Product (GDP) is an inflation-adjusted measure that reflects the value of all goods and services produced by an economy in a given year. Nominal Gross Domestic Product is gross domestic product (GDP) evaluated at current market prices. The S&P 500 Index is an unmanaged index comprised of 500 widely held securities considered to be representative of the stock market in general. The Russell 1000 Index is a market capitalization weighted benchmark index made up of the 1000 largest U.S. companies in the Russell 3000 Index. The Russell 2000 Index is an unmanaged index considered representative of small-cap stocks. The PCE (Personal Consumption Expenditure) Index of Prices is a US-wide indicator of the average increase in prices for all domestic personal consumption. Using a variety of data including U.S. Consumer Price Index and Producer Price Index prices, it is derived from personal consumption expenditures; essentially a measure of goods and services targeted towards individuals and consumed by individuals. The Producer Price Index (PPI) program measures the average change over time in the selling prices received by domestic producers for their output. The prices included in the PPI are from the first commercial transaction for many products and some services. FAANG is an acronym for the five of the market's most popular tech stocks, namely Facebook, Apple, Amazon, Netflix and Alphabet's Google. The North American Free Trade Agreement (NAFTA) is an agreement signed by Canada, Mexico, and the United States, creating a trilateral trade bloc in North America. The Seasonally Adjusted Annual Rate (SAAR) is a rate that is adjusted to take into account typical seasonal fluctuations in data and is expressed as an annual total. SAARs are used for data affected by seasonality, when it could be misleading to directly compare different times of the year. The Atlanta Fed GDPNow forecasting model provides a "nowcast" of the official estimate prior to its release by estimating GDP growth using a methodology similar to the one used by the U.S. Bureau of Economic Analysis. GDPNow is not an official forecast of the Atlanta Fed. Rather, it is best viewed as a running estimate of real GDP growth based on available data for the current measured quarter.

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