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insight

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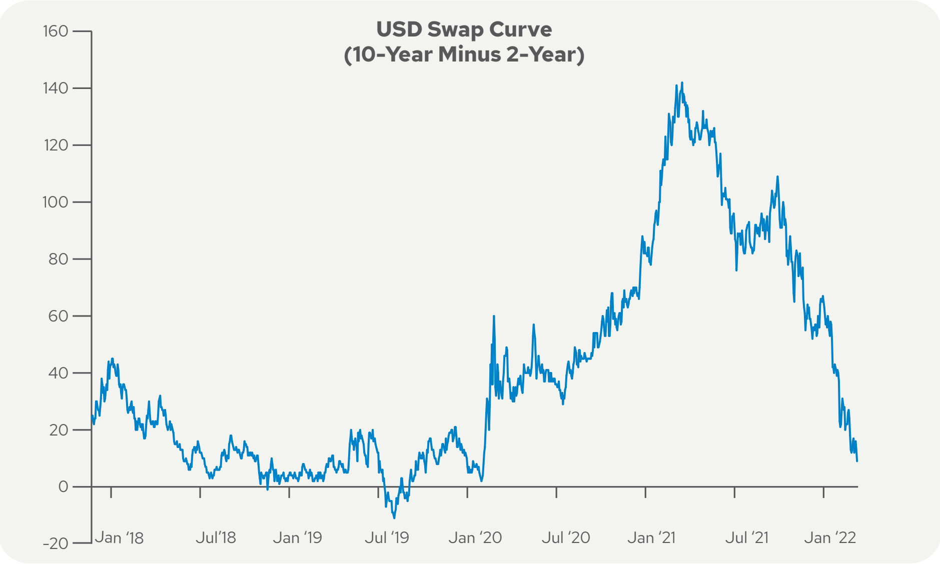
The Pre-Recession Progression...

The burden of proof appears to have shifted to the bulls. With the ramp-up of war in Ukraine, the concomitant stress on already impaired global supply chains, and further dislocation in the industrial and agriculture commodity markets, doubt about the durability of the post-Covid-19 recovery now exceeds—*by our lights*—the case supporting an organic global economic expansion (i.e., an expansion devoid of fiscal or monetary support). This is not to say we believe the base case for the US is recession. Strategas's chief economist, Don Rissmiller, lamps the odds of the US economy contracting through the end of 2023 at 1-in-3 (35%)—largely owing to persistent strength in the US labor market. (US initial jobless claims fell 214,000 last week.) Rather, it is to highlight that with the Federal Reserve officially initiating a tightening cycle last week amid all of this, risk asset markets—*all of them*—are likely to exhibit heightened volatility in the near term, or until we have visibility on how all the above will resolve.



The most pressing issue, of course, is the near-term outcome and longer-term effect of Russia's invasion of Ukraine. Although certainly not our area of expertise, but with an eye toward insight that could be helpful, we noted a recent paper by Nirit Pisano, Ph.D., Chief Psychology Officer at Cognovi Labs, on the emotional state of Russian president Vladimir Putin. Dr. Pisano describes the "significant emotional transition" in Putin's cognitive marker for "Hope." She writes of Putin, in the lead-up to the invasion, "With heightened hopefulness, anticipation, and optimism surrounding his cause and his projected outcome, [he] became emotionally armed and ready to invade his neighbor." The concerning takeaway from Dr. Pisano's assessment is the amplification of the Russian president's resolve after two-plus weeks of conflict; she writes further, "Putin's emotional state conveys more preparedness and less fearfulness than that of his recent past," and concludes, "[his] emotional communications reveal a dynamic and robust emotional state." This new envelope of war may just be opening.

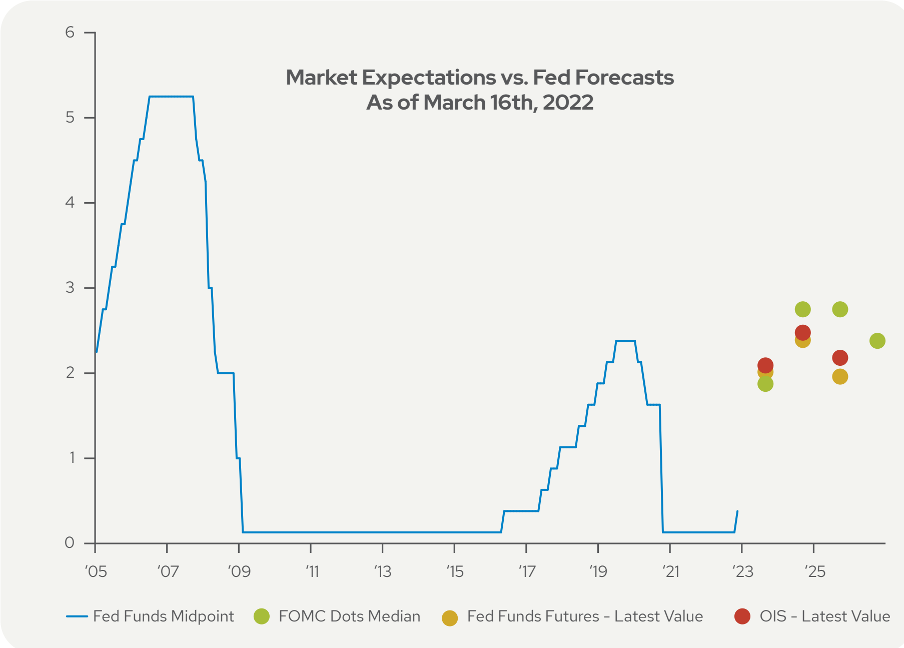
Complicating the matter is the advent of longer-term and structural considerations that poke at the fabric of long-held post-World War II trade and financial markets operating conventions. The drumbeat of de-globalization has yet to reach a fevered beat, but the marked inclination toward nationalism increasingly seen over the past decade appears to be openly and increasingly discussed—*globally and across political affiliation*. Investors will be wise to raise their awareness of data points that stick out against convention. In this way we are attuned to the West's swift (no pun intended) weaponization of the global monetary system to choke off Russia's access to the global economy as it invaded Ukraine. Although we do not believe the end of the dollar's reserve currency status is at hand (the stock and flow of dollar-denominated debt still dominates), we note evidence of "another way," e.g., institutional focus on blockchain and other distributed technologies and the steady increase of agreements to settle bilateral trade directly in the national currencies of the counterparties, e.g., Saudi Arabia's acceptance of Chinese yuan for settlement of oil.

For portfolios, it seems clear that war and all of its knock-on effects have pushed Europe closer to recession, if not already into contraction. Developed international markets already have made a sharp move lower, and with this writing we are reducing our above-benchmark allocation to international shares. Cutting more finely, we now have below-benchmark exposure to developed markets equities and a benchmark (i.e., neutral) allocation to emerging markets shares in our global allocation portfolios. For an active approach, within the Strategas Global Policy Opportunities ETF (NYSE:SAGP), we have been allocated to non-US defense, energy and materials, and biotech/pharma names during the recent spate of market weakness.

We continue to prefer commodity-exporting economies versus service-oriented markets across the varied emerging markets. It is worth noting that we had been modestly underweighted to EM in our managed portfolios (i.e., real money) versus our proclivity on paper due to the dearth of liquid EM access points (ETFs) without outsized China equity exposure we saw available to most advisors. However, Todd Sohn, who does excellent ETF and fund flow research for Strategas, has noted a sharp increase in "EM ex-China" products added to advisor platforms in recent months, allowing us to realign our model and managed portfolios.

Well telegraphed, the FOMC's move on March 17 to raise its overnight policy rate 25 bps and signal at least six additional tightenings this year—*with a potential 50 bps hike in the mix and Quantitative Tightening starting as early as this summer*—shows its desire to "catch up" against growing institutional discomfort within the Fed that it has been wide of the mark on inflation this cycle. War in Ukraine may have taken a 50 bps move off the table, but appears to have informed the Committee's more hawkish guidance, noted by the policy statement, "…the invasion and related events are likely to create additional upward pressure on inflation…" Last month we increased exposure to Treasurys to reduce our duration underweight. Treasurys have softened further, but with credit spreads widening we see an opportunity to add long duration investment grade bonds exposure. Chair Powell pushed back on the prospects of a near-term recession in the US, but the mix of high and rising inflation, supply chain dislocation, and a flatter yield curve has investors and the Fed on alert. As Strategas's fixed income strategist, Tom Tzitzouris, notes, when the Fed raises interest rates, the impact is felt most acutely on Main Street, but when the Committee reduces the size of its balance sheet, the impact is felt on Wall Street. At inflection points, tactical vigilance is necessary; there are few places to hide.

The *protection* offered in a "60/40" portfolio has left something to be desired in recent months, with both stocks and bond prices under pressure. Further deterioration on the economic front coupled with higher nominal rates is unlikely to provide much relief in the near term. Our approach to



counteract this had been to engage a more proactive management of style, size, and geographic tilts in the equity sleeve of our allocation portfolios, to dramatically underweight fixed income versus benchmark and manage duration, and to maintain an elevated cash allocation.

We remain neutral to slightly overweight equities (62% versus 60%) in our research benchmark. We maintain below-benchmark exposure to fixed income at 30% (with 8% exposure to cash and gold) versus 38% and 2%.

Believing that inflation was likely to be higher and less *transitory* than hoped for, we introduced, and subsequently increased to 4%, a modest allocation to gold in our portfolio last summer. Although we remain convinced that inflationary pressures are unlikely to abate in the intermediate term—"higher-for-longer inflation" is one of four thematic exposures in our Strategas Macro Thematic Opportunities ETF (NYSE:SAMT)—we are cautious about adding blanket commodities exposure to client allocation portfolios. Naturally volatile, particularly at points of global economic stress, the proliferation of commodity-linked ETPs has only increased market fluctuations. Tread carefully.

And so, it would seem that vigilance carries the day once more. It is important for investors to maintain discipline and stick with their plan. Adjust as necessary, but do not overreact. It appears the building blocks of change are being laid. We will keep watching together.

Strategas Recommended Asset Allocation (March'22)

	Equities	Bonds
Overweight	US MC Value US SC Core US LC Value	Bank Loans IG Corporates
Neutral	US LC Growth EM AC Core US MC Growth Dev AC Core	ABS/CMBS Agencies TIPS US Dollar EMD
Underweight	US LC Core US MC Core	US MBS U.S. Treasuries

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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.

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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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Alternative Investments may have complex terms and features that are not easily understood and are not suitable for all investors. You should conduct your own due diligence to ensure you understand the features of the product before investing. Alternative investment strategies may employ a variety of hedging techniques and non-traditional instruments such as inverse and leveraged products. Certain hedging techniques include matched combinations that neutralize or offset individual risks such as merger arbitrage, long/short equity, convertible bond arbitrage and fixed-income arbitrage. Leveraged products are those that employ financial derivatives and debt to try to achieve a multiple (for example two or three times) of the return or inverse return of a stated index or benchmark over the course of a single day. Inverse products utilize short selling, derivatives trading, and other leveraged investment techniques, such as futures trading to achieve their objectives, mainly to track the inverse of their benchmarks. As with all investments, there is no assurance that any investment strategies will achieve their objectives or protect against losses.

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