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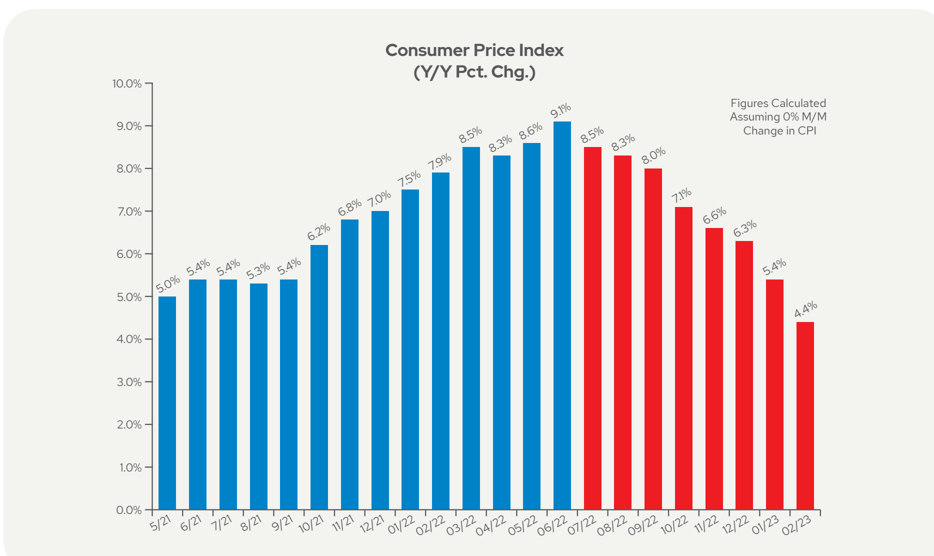
Be Warned, the Countertrend Rally

As recently as last month, there appeared to be a certain sense of complacency among our clients that the market drawdown, will all be over soon. Further weakness and the begrudging acceptance that the severity of current inflationary pressures, in combination with a battery of pandemic-related dislocations and geopolitical uncertainties, appeared to move investors to accept that bottoming will be a process. But no sooner than investors could open their 2Q statements, we saw the S&P 500 again rebound to flirt with 4,000, a level last seen in early-June. The refrain, 'is it over?' became a July 4th holiday utterance of, 'is it for real?' Crude Oil is down -$25. Copper is down roughly -25%. Perhaps the Fed has arrested the evil Scrooge? We're not convinced. Consider the overwhelming fiscal and monetary response deployed to combat the recession as governments ordered the global economy to a near-subsistence crawl. The bill was going to come due, sooner or later because of the overwhelming fiscal and monetary response deployed to combat the recession as governments ordered the global economy to a near-subsistence crawl. Given the current proclivities of policymakers, particularly of the monetary ilk, that bill likely needs to be paid in full.

Despite the market's recent advance, the macro picture does not seem to support the move. 10-year Treasury yields have moved sideways but 2-year yields are +50bps higher, as evidenced by the sharp inversion of the 2/10 curve. U.S. initial jobless claims rose to +244,000 last week, indicating continued weakening in labor conditions. The consumer sentiment remains depressed with the UMich survey at 51.1 for July; U.S. industrial production fell -0.2% M/M in June; the Euro, the Yen, and the Yuan are all meaningfully weaker. The Fed's Beige Book noted an increased risk of an economic downturn. The Atlanta Fed GDPNow model is currently indicating that growth in the second quarter fell -1.6%. Ifaccurate, it would mark the second quarter in a row of negative GDP, the imperfect heuristics generally used to determine whether an economy is in recession. Looking at the composition of disequilibrium presents an atypical profile. History suggests the U.S.



economy does not contract without labor-market weakness. As Strategas, Vice Chairman, Chief Economist, Don Rissmiller has posited, if we have a "jobs-plentiful recession" in 2022that would be odd and – more importantly –is not likely enough to dampen inflation enough to satisfy the Federal Open Market Committee. Despite modest easing of global supply chain dislocation, global growth (i.e. GDP) is weakening without the cycle-resetting flush that would accompany significant job loss. Don thinks this may be coming. Moreover, the Committee appears keyed on inflation more than growth and likely wants to avoid a stop-and-go monetary policy. For a battery of reasons, we believe the Fed will continue to tighten until it becomes obvious that significant progress has been made in curbing inflation and until it's clear inflation expectations are anchored.

Though we have seen a notable drawdown in commodity prices, there appears little data sufficient enough to convince policymakers not to move toward an increasingly restrictive application of monetary policy. Growth could take a further hit in the face of increasingly tighter financial conditions. It should be noted that, at least historically, earnings have fallen by 30% on average in past recessions. Although a case can be made that current market multiples already reflect a higher-inflationary environment, it would be difficult to suggest, based on sell-side data that lower earnings expectations have been fully factored into current stock prices. Sell-side earnings expectations remain at $250 for 2023, roughly a +10% increase from 2022 forecasts. We remain of the view that broader trends in both the economy – weaker – and the market – lower – are, unfortunately, intact.

In this environment, we see little incentive to shift broad allocations to the major asset classes. We remain neutral Equities (60% in our 60/40 benchmark allocation portfolio), a position we established several months ago after carrying a material overweight during much of the post-pandemic rally in stocks.

in the value-oriented sectors like Energy, there are candidates in every sector. And, as we have for the last several months, we continue to make tactical shifts within our fixed income portfolio. Though we do not find Treasuries to be particularly cheap, we find it unappealing to continue to carry a duration short during a period of deteriorating economic growth.

Strategas Recommended Asset Allocation Jul'22

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

While strong counter-trend rallies in the equity market can persist, we would advise against violent temptation of speculative counter-trend rallies in risk beta (e.g. China, Biotech, etc.) for longer-term investors. We remain inclined to sell into near-term strength, preferring to position in the comfort of higher quality and more defensive shares for the intermediate-term. We believe thematic momentum remains in four key areas: 1) Inflation for Longer; 2) Quantitative Tightening; 3) Cyclical Defensives; and 4) De-Globalization. We continue to recommend investors stick with shorter-duration equities that throw off large amounts of cash, obviating their need to be held hostage to increasingly difficult-to-access capital markets. Although such companies are more easily found

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.

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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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