STRATEGAS

insight

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No Rest for Investors

We have written at length on the vagaries of 2020, but the last month has been notable for the volume and disparity of *incoming* investors have had to process. Although the broad market reaction in March and April was certainly more acute, understanding *why* (and the implications of *why*) was far easier. Six months on, investors increasingly appear to have a "handle" on the virus. This is not to suggest that the virus is no longer an issue—*it is*—or that the necessary amount of point-of-care testing is available—*it is not*. Nor is it meant to diminish in any way the real loss so many people have experienced at the hands of COVID-19. It is only to posit the notion that as society learns to live with the virus, however unpleasant, the impact that its ebb and flow has had on the markets—specifically the equity market—has diminished. In its place is a menu of important issues, any one of which investors would typically digest with exhaustive care away from the *sturm und drang* of the capital markets. More and more, they just do not have the time before another substantive issue comes into view.

One could argue that the endgame, in its simplest form, for investors is to keep their financial goals in sight and to react appropriately to the time ladder of risks to ensure they remain on track. At no point in the cycle is this trickier than at the top, which generally comes *without warning*, inasmuch as we are blind to deteriorating economic conditions and we are off the bottom. This second inflection point, "off the bottom," is what investors are grappling with today. In a typical business cycle, the variance between "trailing data," reflecting the period just passed, and "forward *data*," reflecting expectations for future periods, is never wider than during the recession-to-recovery transition. Said simply, it is the point in the cycle at which the trailing data are at their worst and the outlook, at least relatively, is at its strongest. Anecdotally, we see this when our conversations with clients turn from interpreting events and data in their moment—*as was the case in March and April*—toward interrogating the merit of the assumptions propping up the longer end of the forecast curve as it steepens—*even if it is a year or two ahead*. A shorter field of vision generally accompanies uncertainty; a longer field of vision generally is accompanied by optimism.

Inasmuch as the equity market remains a discounting mechanism of expected risk-adjusted returns, and given that uncertainty about the virus and its impact on the markets appear to be easing on the one hand, while signs the economy continues to gather momentum intensify on the other, it is interesting that investors have not become more universally bullish. What is holding the market back?

One answer would seem to be the firm grasp that competing all-or-nothing political outcomes have on investors' mindshare. Without wading too far into the political, one takeaway from the debate several weeks ago between President Trump and former Vice President Biden is simply that everything has become politicized. And although it may be obvious that the volume of political vitriol and associated legislative jockeying would increase in an election year, that neither party seems willing to concede an inch in the obvious service of the common good leaves us with little hope that the election itself—

regardless of the outcome—will foster timely reconciliation on the pressing points of policy being debated. This is particularly notable in two key areas that likely will have implications for the recovery well beyond Election Day:1) the natural tension inherent in weighing freedom versus safety (as it relates to municipal lockdown and reopening), and 2) the size and target of additional fiscal stimulus. This strikes us as an important issue, given the economy's arguable reliance on reopening and the provision of addition fiscal stimulus to recover more robustly.

Readers of our work will recall the list of four signposts we have used since the onset of the pandemic to better understand the depths of the decline and the breadth and durability of the ensuing recovery. These are: 1) containment and cure of the virus; 2) an understanding of trough levels of activity and areas of acute dislocation; 3) a reasonable forecast for the slope of the normalized forward-demand curve; and 4) the driver (or drivers) of organic growth available to transition the economy from recovery to expansion. Of the four, it seems only #2, "an understanding of trough levels of activity and areas of acute dislocation," can be checked off. So where does that leave us? Although it may seem stale, our readers will know we remain comfortable with an above-benchmark allocation to both equities (64% vs. 60%) and cash (9% to 2%). If market action in September is any indication, we see no incentive to position portfolios decidedly in one direction (i.e., *bullish*) or the other (i.e., *bearish*). The economic backdrop appears to be improving, albeit in fits and starts, given the two governing issues we noted above (*reopening* and *stimulus*). This should be taken as a positive, but in our view, it is likely that the easier part of the recovery is behind us. This invites a degree of caution.

The question we are most frequently asked by investors in our tactical portfolios is for our views on growth versus value. In short, we continue to favor growth over value. This is due, in part, to the persistent unevenness of the recovery as much as it is an acknowledgement of the dominant weights in the composition of the benchmark indices. Should the normalized forward-demand curve (#3 on our list of signposts) steepen, particularly with support of organic drivers of growth to aid in the economy's transition from recovery to expansion (#4 on our list), then it is reasonable to reorient the portfolio toward value. In the meantime, we are willing to wait.

Strategas Recommended Asset Allocation (Oct '20)		
	Equities	Bonds
Overweight	US LC Growth US MC Growth	IG Corporates
Neutral	Dev AC Core US LC Value US LC Core US MC Value US MC Core US SC Core EM AC Core	Agencies ABS/CMBS US Dollar EMD TIPS High Yield Banks Loans
Underweight		US MBS U.S. Treasuries

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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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