STRATEGAS

insight

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At the Ready: The Re-emerging Recovery

Strategas Asset Management's suite of balanced portfolios—available on Envestnet—are managed to align client goals and risk preferences over a medium-term time horizon. Each portfolio combines Strategas's strategic asset allocation with the tactical tilts discussed in these pages. Increasingly, among the long list of "uncertainties" compelling us to reduce exposure to equities within our global allocation portfolios last month, (to 62% from 67% vs. 60% neutral exposure) and to raise cash (to 8% from 6%), we find discussions with advisors and their clients focused on two as we head into Q42021. First, it is becoming clear that dislocation in the global supply chain—*bottlenecks and supply constraints*—continues to hamper 2H2021 economic activity while intensifying concern that inflation will remain stickier, longer than the Federal Reserve (Fed) has found itself willing to admit (at least publicly). Second, although the brinksmanship over the debt ceiling may have subsided (for the moment) the Administration's policy objectives appear too ambitious in size and scope, given the narrowness of Democrats' Congressional majorities. Without making a normative judgment, lingering uncertainty on such a far-ranging package of relatively dramatic policy changes likely has retarded private sector engagement in the nascent recovery. Operating companies effectively have seven outlets to deploy corporate cash flow: buybacks, dividends, acquisitions, debt retirement, labor, capital expenditures, and profits. The sharp increase in operating profits has helped buoy the stock market, but a less-than-enthusiastic embrace of the other six outlets (namely capital expenditures) has left in question the durability of the economy's transition from recovery to self-reinforcing expansion.

Though it is certainly possible the economy has enough shoulder to marshal an organic and relatively smooth transition into a durable and self-reinforcing expansion, we believe the risk temperature increases the burden of proof in the near-to-intermediate-term. We are comfortable with reduced exposure to equities for now, mindful that we have cash to deploy should the fever break. For investors questioning the merits of staying long equities at all, we would argue that the steady, albeit jagged, reopening of the economy, the concomitant improvement in corporate revenues, and broadly accommodative monetary policy suggest a number of trends must reverse before we would shift to a counter-cyclical posture. Our decision to lower equity exposure was largely an attempt to inoculate our portfolio from the mounting policy hurdles facing (and created by) Congress. For the moment, that appears to have been the right call for tactical allocators. Washington is a mess.

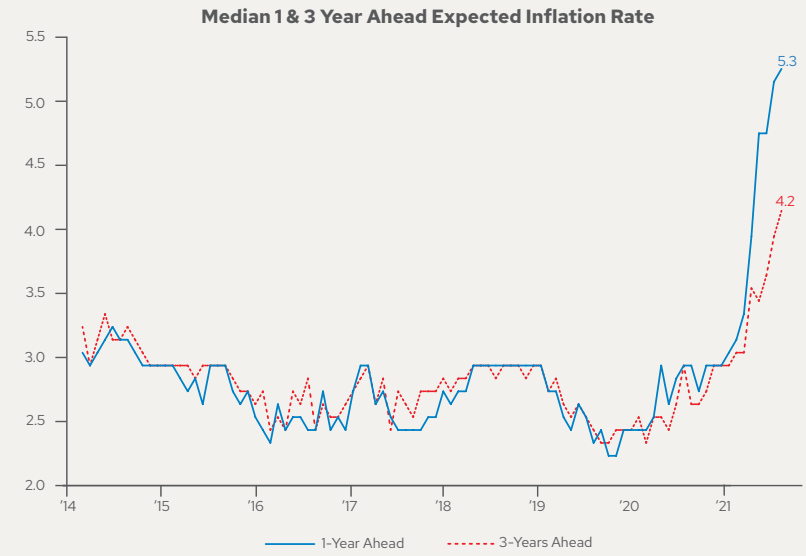
Strategas's chief investment strategist, Jason Trennert, has described the investors' year as a "tale of two markets": higher long-term interest rates coupled with the outperformance of traditional cyclicals, both to start the year, and again, more recently, interrupted by lower rates and the relative strength of growth stocks in Q22021. Strategas's chief economist, Don Rissmiller, believes we will continue to weather a stagflation scare—*weaker growth + sticky inflation*—into 2022, given the persistence of bottlenecks and supply

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

constraints in the economy. But he posits that as corporate operators change the way they do business to combat this circumstance, we will see an increase in productivity, which allows for the opposite effect—*stronger growth + muted inflation*. Straining the economy in ways it has not been tested since the 1970s might result in the emergence of evolving business processes today … out of necessity. The market may be beginning to suss this out, but it will take time for confidence to firm enough to pull in assets.

The elephant in the room, of course, is interest rates. Investors have a growing sense that the Fed has put itself in a position where it cannot raise rates. The market, however, is searching for balance against mounting evidence pointing to higher trend inflation. The latest New York Fed survey of consumer expectations lamps inflation at ~5% over the next 12 months and at ~4% three years out (and this trend continues decidedly to the upside). So inasmuch as the Fed may be boxed in, we already have seen modest-to-acute selling on the long end of the curve globally, which has pulled rates off their midsummer lows. French bond yields went positive in September, German bond yields are on the verge of going positive for the first time since April 2018, and Swiss bond yields are getting there. In using 1.8% as our year-end forecast for the yield on the 10-year U.S. Treasury Note, we hardly are forecasting an abrupt recoupling of interest rates and trend inflation, but we would suggest that more is likely to come.

With long rates moving higher, cyclicals have regained near-term leadership. Global imbalances are well discounted, and expectations for growth in Q3 and now Q42021 have been level set. Thus, we believe we are well positioned to increase exposure selectively to traditional cyclicals as the three prevailing macro trends firm: higher inflation, higher rates, and the economy's emergence from the summer growth scare. Among US equity sectors, we continue to recommend above-benchmark exposure to: Energy, Industrials, Financials, and Materials, and recently upgraded Consumer Discretionary to an overweight. This leaves our portfolios with neutral exposure to Health Care, Technology, and Real Estate. We are underweighted to Consumer Staples and Utilities, which by dint of their lackluster performance during the recent bout of uncertainty, underpin our conviction in remaining biased toward cyclicals. The road through uncertain times is generally not smoothly paved; that is the road we are on now.



Source: New York Fed Survey of Consumer Expectations

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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