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insight
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The Five Bottlenecks of Uncertainty

Uncertainty remains the theme for our team. A laundry list of uncertainties compelled us to reduce broad exposure to equities within our global allocation portfolios back in September (to 62% from 67% vs. 60% neutral exposure) and to raise cash (to 8% from 6%). Although discernible points of improvement on some fronts are apparent (debt ceiling, tax increases), altogether too few of the uncertainties investors have been wrestling with since the summer have been eliminated entirely (or sufficiently enough to be crossed off the list). If anything, the list may have grown.

Inflation may be the most prevalent uncertainty at the moment. What began mathematically as the Y/Y reciprocal to three months of deflationary price shocks in 2Q2020 and the "transitory" knock-on effects of mandating the global economy to a near subsistence crawl has metastasized into a worrisome guessing game centered on the duration and intensity of what Don Rissmiller describes as four global bottlenecks—*product, transport, labor*, and *energy.* We might add a fifth—*policy,* (though we are not sure that is either a new phenomenon or a particularly transient one). Headline and alternate measures of inflation continue to rise, whereas real earnings remain negative. Policymakers have begun to accept that the inflationary environment is cause for concern. But they have yet to accept blame, and seem generally powerless to ease its burden directly, despite pressure mounting for them to "do something."

On a positive note, however, Don and our economics team see some evidence that we may be approaching "peak bottleneck," which he describes as a precondition to "peak inflation." This suggests that the worst-case scenario—a "1970s style" stagflation—may be off the table, but easing these dislocations operates with a notable lag, with sufficiently few signposts supporting a return to pre-Covid-19 levels of inflation during this economic cycle. Expansionary fiscal and monetary policies are hard to stop without economic pain. Without making a normative judgment, given the far-ranging package of relatively dramatic policy changes being championed by the Congressional Democrats, it seems unrealistic to think the size and scope of our fiscal appetites will be curbed anytime soon. Thus the pressure for the Federal Reserve (Fed) to do *something*. Calls have intensified to both increase the pace of advertised tapering and to tighten (though it should be noted that tapering asset purchases must be completed before a tightening program can begin). Yet private sector engagement in the nascent recovery has been uneven. Although retail sales—*the sales of things*—have been way above trend, this will likely come down; the necessary offset, services, is suppressed due to bottlenecks in the labor market. Considering its dual mandate, the Fed appears to be in a pickle. But "who" is the Fed? If policy is personnel, President Biden's notable delay in putting forward a nominee to chair the Fed is compounding the matter—*and, we would posit, borders on a policy error.*

As we have noted, operating companies effectively have seven outlets to deploy corporate cash flow: buybacks, dividends, acquisitions, debt retirement, labor, capex, 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 capex) has left in question the durability of the economy's transition from recovery to self-reinforcing expansion. Important barometers are starting to flash warning signs: Profit margins have begun to roll over, and earnings yields have turned negative. Neither is typically associated with strong forward returns.

To be fair, absent some late-summer/post-Labor Day volatility, the market has shrugged off much of this uncertainty. Although we have remained modestly bullish and generally are inclined to continue to selectively increase exposure to traditional cyclicals, we have not found sufficient rationale to reverse our September move to reduce exposure to equities. We do, however, see merit in tactical adjustments to the fixed income side of the portfolio. We have further increased our underweight to duration, specifically trimming exposure to long duration investment grade corporates and increasing exposure to short duration investment grade bonds and bank loans, given the higher likelihood of capital loss from mounting inflation risk in longer duration paper. High yield does not offer the same protection from rising rates that it used to. We also have moved to reduce mortgages within the portfolio, as marginal buyers have signaled their intent to move away from the asset class.

We see the investing landscape being defined by choppiness associated with the *five bottlenecks* into mid-CY2022. Thereafter, much will depend on how policy levers were pulled to get the economy flowing smoothly. The chance is low that this will be accomplished without acute pockets of dislocation.

Strategas Recommended Asset Allocation (Nov'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

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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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