



In this month's Insight, Nicholas Bohnsack discusses the mounting policy hurdles and the uneven road to recovery.



Nicholas Bohnsack is the President & Chief Executive Officer of Strategas Asset Management and a Managing Director of Baird.

## *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' 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 main topics as we head into 4Q'21. First, it is increasingly clear that dislocation in the global supply chain – *bottlenecks and supply constraints* – continues to hamper 2H'21 economic activity while intensifying concern that inflation will remain stickier and longer than the Fed has found itself willing to admit (at least publicly). Second, while the brinkmanship 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 judgement, lingering uncertainty on such a far-ranging package of relatively dramatic policy change has likely 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, capex, and profits). As the sharp increase in operating profits has helped buoy the stock market, there has been a less-than-enthusiastic embrace of the other six outlets – namely capex – leaving the durability of the economy's transition from recovery to self-reinforcing expansion in question.

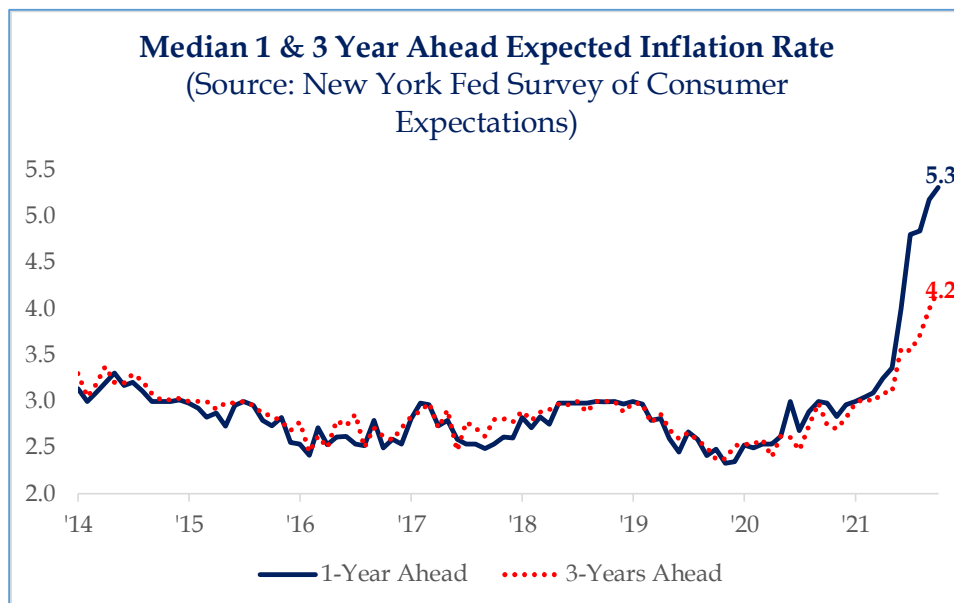
Though it is certainly possible the economy has enough shoulder to marshal an organic and relatively smooth transition into a durable and self-reinforcing expansion, we believe the risk temperature increases the burden of proof in the near-to-intermediate-term. We're comfortable with reduced exposure to Equities for now, mindful that we have cash to deploy should the fever break. For investors who question the merits of staying long Equities at all we would argue that the steady, albeit jagged, re-opening of the economy, the concomitant improvement in corporate revenues, and broadly accommodative monetary policy suggest there are several trends that would need to reverse before we would shift to a counter-cyclical posture. Our decision to lower Equity exposure was taken largely as 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.

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

Strategas' 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 2Q'21. Strategas chief economist, Don Rissmiller, believes, given the persistence of bottlenecks and supply constraints in the economy, we will continue to weather a stagflation scare – *weaker growth + sticky inflation* – into 2022. 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. There is a growing sense among investors that the Fed have put themselves in a position where they can't raise rates. The market, however, is searching for balance against mounting evidence pointing to higher trend inflation. The latest NY 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 have already seen modest-to-acute selling on the long-end of the curve globally, which has served to pull rates off their mid-summer lows. French yields went positive in September, German yields are on the verge of going positive for the first

time since Apr'18, and Swiss yields are getting there. In using 1.8% as our year-end forecast for 10-year U.S. Treasury yields we're hardly forecasting an abrupt re-coupling of interest rates and trend inflation, but we would posit there is likely more to come.



With long rates moving higher, cyclicals have regained near-term leadership. We believe with global imbalances well-discounted and expectations for growth in 3Q and now 4Q'21 having been level set, we are well-positioned to selectively increase exposure to traditional cyclicals as the three prevailing macro trends – *higher inflation, higher rates, and the economy's emergence from the summer growth scare* – firm. Among U.S. 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 underweight Staples and Utilities, which by deign 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's the road we're on now.

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