STRATEGAS ASSET MANAGEMENT

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In this month's Insight, Nicholas Bohnsack discusses navigating the Delta variant and the economy's frustratingly jagged nascent recovery in global growth.

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

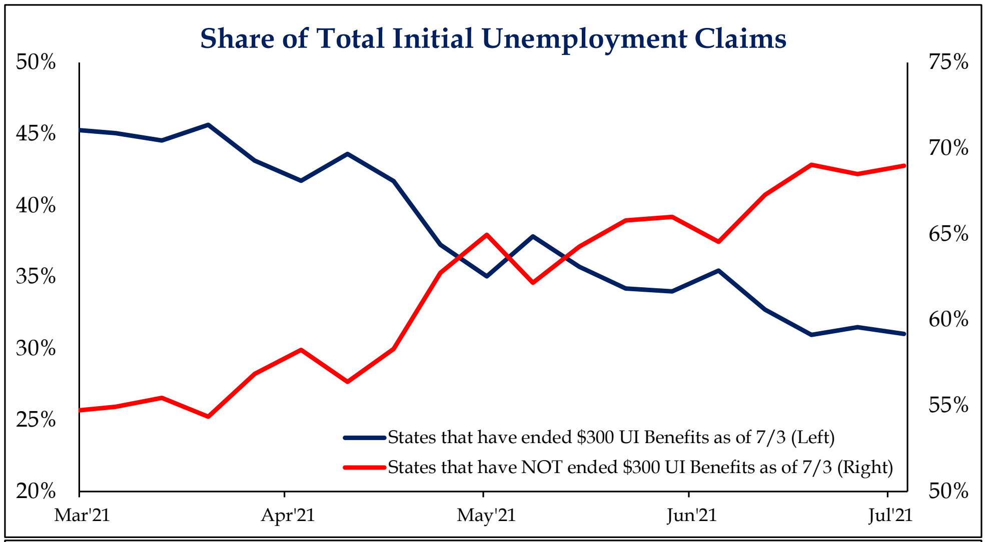
At the Junction of *Wrong* or *Right*

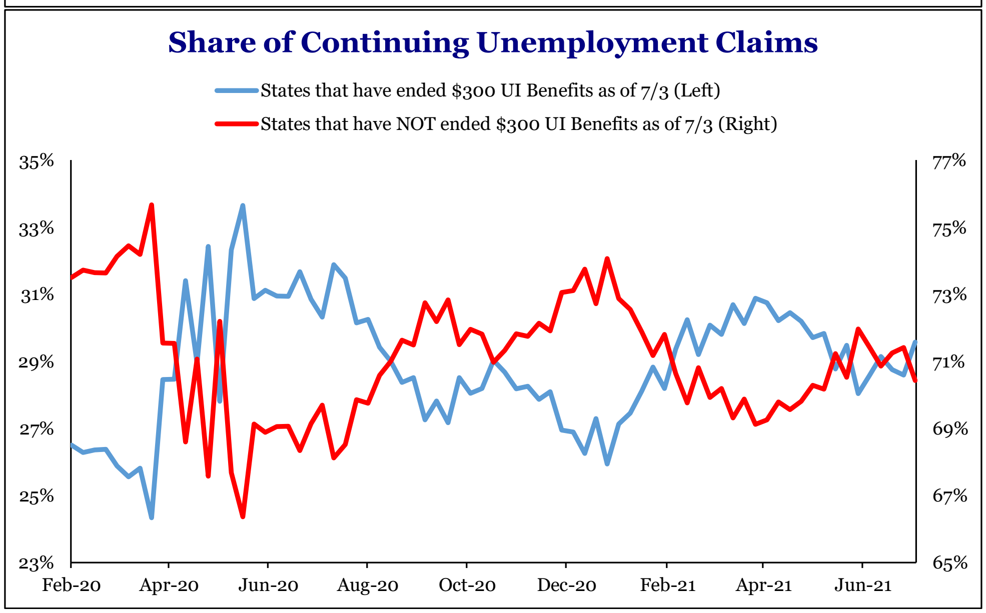
Readers of our work will know we have remained generally optimistic (some would say, hopeful) on the prospect that the nascent recovery in global growth, albeit frustratingly jagged, will continue to transition into a cyclical economic expansion. No doubt we are mindful of the narrative tugging at the market's advance suggesting the current improvement in – and levels of – *activity*, *demand*, *output*, *revenue*, and *profitability* are little more than the manifestation of a generationally-accommodative policy framework… susceptible to moderation – or even, reversal – should the proclivities of the Open Market Committee change.

For the 6+ months ending March, investors' bias appeared to tilt toward our base case (i.e. a strengthening cyclical recovery). Positioning, within Equities, tended toward traditional Cyclicals (with many in the financial arena focused on resurgent Value shares almost to the exclusion of all else). Fixed Income exposures remained generally below benchmark, short duration and, peppered with larger-than-normal positions across extended credit sectors. In the period since, most acutely since early-May, the consensus appears to have shifted its sympathies toward – or, at least acknowledge more fully – the policy-driven narrative. Indeed, the strong move into Value has abated. Growth shares, while not running away entirely, have seen sufficient inflows to level the tape. The long-end of the curve has been relatively well bid, with 10-year Treasury yields falling from ~1.75% in late-March to ~1.30% with this writing, the yield curve (2s/10s) has flattened, and the Dollar has strengthened.

Sticking with the cyclical trade – *Value vs. Growth, International vs. Domestic, Small & Mid-Cap vs. Large & Mega-cap, higher long rates, and a weaker Dollar* – is currently not *in trend.* Investors discounting economic growth to come in north of +10% Y/Y have had to settle for +7-8%. Global bottlenecks undoubtably persist. Peak earnings are a worry (and the market has not really begun to incorporate higher corporate tax rates). As our Economics team highlights, China's growth is slowing. Perhaps most concerning, uncertainties surrounding the "Delta variant" are waxing as evidenced by increased case counts in geographic centers previously considered to have largely "cleared" the virus or, at least, showed an improving trend. More than the rotation within equities (Growth vs. Value) or any concern that inflation could, ultimately, be "stickier" than policymakers have intimated (or, hoped), recent strength in the U.S. Dollar and the concomitant decline in long rates does suggest the consensus has lowered expectations for the slope of the normalized forward demand. While slowing momentum appears to own the moment, not all data are so dire, particularly on the labor front (initial claims numbered just ~375,000 last week and the number of job openings continues to increase). We continue to watch the interplay between expiring extended unemployment benefits – now in 27 U.S. states – and lower unemployment levels. While a hot political topic, the impetus to return to the workforce appears related to the government's provision of an income backstop for not returning to the workforce. We (and, *hopefully* is the right word in this case) believe this improving trend in employment will continue as schools re-open more fully in the Fall.

Alaska	12-Jun
Iowa	12-Jun
Mississippi	12-Jun
Missouri	12-Jun
Alabama	19-Jun
Idaho	19-Jun
Indiana	19-Jun
Nebraska	19-Jun
New Hampshire	19-Jun
North Dakota	19-Jun
West Virginia	19-Jun
Wyoming	19-Jun
Arkansas	26-Jun
Florida	26-Jun
Georgia	26-Jun
Ohio	26-Jun
Oklahoma	26-Jun
South Dakota	26-Jun
Texas	26-Jun
Utah	26-Jun
Montana	27-Jun
South Carolina	30-Jun
Tennessee	3-Jul
Maryland	3-Jul
Arizona	10-Jul
Louisiana	31-Jul





As an aside, if reliance on monetary policy alone (or, in large part) will govern positioning in the months ahead, it may be worth revisiting a point we made last month on these pages: we are hard pressed to recall a Fed meeting (and, subsequently, minutes) more picked over for the tiniest suggestion that the prevailing policy framework will change than that of the Fed's June 15-16th session. The amount of ink spilt (to use a phase) dissecting the shift in the Committee's "dot plot" stands case in point. We remain of the view that the *modestly* hawkish tone of the post-meeting statement simply extricated the chairman from the persistent burden of inquiry as to whether the Fed is "thinking about thinking about" normalizing policy. As he articulated in the June press conference and in subsequent Congressional appearances (as recently as this week) we believe Chair Powell has made clear that he does <u>not</u> believe the standard that would allow for such policy normalization has yet to be met. (Only one "dot" on the "plot" really matters.) Consider also that should Jay Powell desire to be nominated to another term as chairman of the Federal Reserve[1] it is more likely the President would be inclined to do so if the stated position of the Chairman on monetary policy were viewed as generally supportive of the Administration's legislative ambitions. (This is not to overly politicize the process – *though it is* – or to suggest the Chair would subordinate his responsibilities to self-interest – *though what is the real difference between tapering in 4Q'21 vs. 1Q'22?*[2])

Returning to the outlook for the economy, what are the merits to positioning for a counter-cyclical downturn? We believe it is fair, given recent market volatility, to say investors are convinced the Fed will remain in their aid for the foreseeable future. Further, while it would be fair to argue that the cyclical trade *had* been priced to perfection, Cyclicals have roundly taken it on the chin in recent months. So, it would be mathematically unlikely that the market could evidence a protracted move lower without being led on the downside by the traditional Growth segments. To say nothing of the gathering regulatory storm brewing overhead for Big Tech.

While we are mindful that the atmosphere certainly seems to invite caution, as our technical strategists Chris Verrone and Todd Sohn have highlighted, we have not seen a confirming move into more traditionally Defensive sectors like Staples and Utilities. Moreover, should the slowing momentum of the recovery prove itself less than transitory, we would envision credit offering a signal. Spreads remain confined to a relatively narrow range.

[1] Jerome Powell's current term as Chairman of the Federal Reserve ends in Feb'22.

[2] Ben Bernanke's nominations to chair the Fed were made in Oct'05 and Aug'09, Janet Yellen's nomination was made in Oct'13, and Jay Powell's was made in Nov'17.

Strategas' fixed income strategist, Tom Tzitzouris, has noted the competing tensions in the direction of long rates are particularly pronounced. On the one hand, the impending debt ceiling debate and potential for tax hikes threaten to keep a lid on yields. While the potential for tapering bond purchases – *particularly MBS and TIPs* – against the threat of "stickier" levels of inflation conspire to push yields higher, on the other. And finally, should the momentum of the recovery slow too much, the provision of additional fiscal aid, beyond the Administration's stated policy initiatives, cannot be ruled out.

So, where from here? There is a tendency, in a pocket of uncertainty, for investors to draw intermediate-term conclusions from every piece of timely "information" to hit the tape. At moments, this approach has merit. But we are not sure this is one of them. Roughly fifteen months off the lows in stocks and 10 to 12 months removed from the trough in economic activity, should our bias be toward cyclicality or counter-cyclicality? As Strategas' chief strategist Jason Trennert reminds us, *the market has basically gone straight up for fifteen months, a little shakeout is OK*. Even welcomed. History reminds us that new investment paradigms (e.g. stagflation) take time to develop. Against that backdrop we believe "the call" is to be optimistic on an economy that appears very much in the early stages of cyclical recovery. Inasmuch, we remain overweight to Equities in our tactical allocation portfolio (67% vs. a benchmark allocation of 60%) and Cash & Equivalents (6% vs. 2%); we are underweight Bonds (27% vs. 38%).

Thomas DiFazio, whose tireless effort and thoughtful analysis make these reports more useful than I could ever offer alone, said it simply earlier this week, "…one way or another, we're at the junction of finding out if we're *wrong* or *right*." I agree. While trying desperately to remain open minded and more reliant on fair analysis and critical thinking, I remain optimistic.

Strategas Recommended Asset Allocation (Jul'21)

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

NB

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