STRATEGAS
ASSET MANAGEMENT

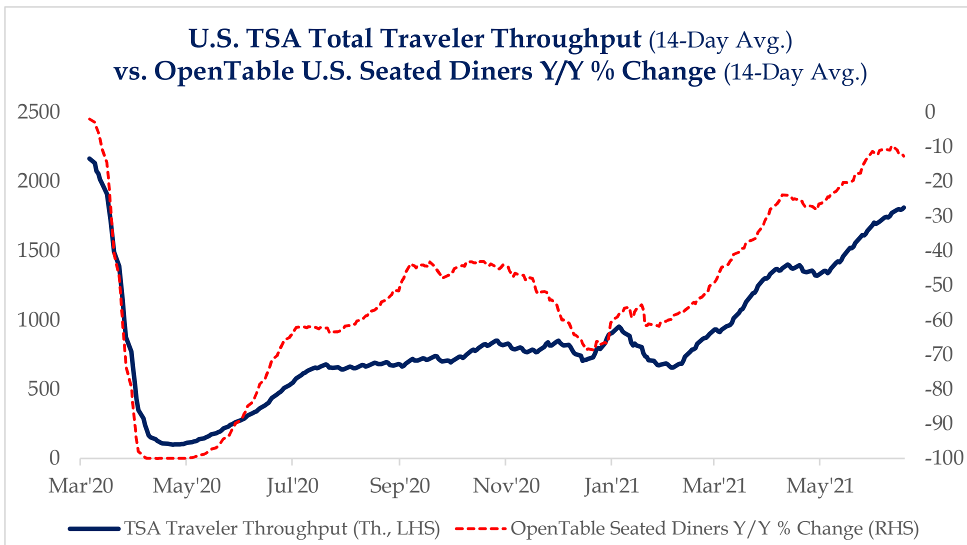
June 21, 2021

In this month's Insight, Nicholas Bohnsack discusses the economy's and Fed's reaction to the impacts of a waning virus and an economic re-opening.

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

Something is Happening – A Recovery Inflection Point

To say that the world has been consumed by the pandemic for the past year would, of course, be an understatement. To suggest that the virus is behind us in full would we be a disservice to all those who continue to suffer its ill effects. But something is happening. Public health restrictions are easing. As the data from the TSA (traveler throughput, i.e., the number of people through the security line at public airports) and OpenTable (seated diners) highlight, the economy is opening up.



Folks are returning to work, to play… The natural (and hopeful) conclusion would be seen to tilt toward optimism. Interestingly, market action over the last month has highlighted a discrete tension between these improving activity trends and a general optimism for continued improvement in the economy – *nobody wants to sell stocks* – and growing concern over ratcheting inflation, and the potential for increased government spending and higher taxes – *nobody wants to buy bonds*. In an effort to soothe this apparent disequilibrium, the Federal Reserve attempted to strike a balance between… the committee's veiled acknowledgement, on the one hand, that inflation may be slightly less transitory than often suggested (by modestly advancing the projected timing of policy normalization) and the Chairman's decidedly more dovish tone at his press conference, on the other, suggesting the standard that would allow for such policy normalization had not yet been met. No easy feat. Thus, we were not surprised to see the market soften in response; the clear takeaway was interpreted as *less accommodative policy, sooner*. It is likely that a broader consolidation and trend reversal may play out into quarter-end given the lingering uncertainties related to the virus we note above and our proximity to the end of 2Q'21 and the increased focus on 2H'21 and CY'22 that is typical mid-year. Cause for concern?

We would liken the Fed's actions to shifting in one's seat after you have been dialed into a Zoom call for an hour. Noticeable on camera to the other participants and illicit a waterfall effect from others, but not likely to end the call. By our lights, the data suggest "the call" remains 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%).

Near-term dislocation provides an opportunity to manage our portfolio towards longer-term shifts in trend. Within Equities we are reducing exposure to Domestic (U.S.) shares and increasing exposure to International (non-U.S.) markets, specifically Developed Market economies. At the same time, within the International sleeve we recommend shifting capital from Emerging Markets into Developed. Changes in and among global equity exposures ultimately devolves into a discussion on currency strength. From a U.S.-centric vantage point, we remain cautious on the Dollar. As we wrote in last month's *Insight*, among our highest conviction themes is the potential for increased pressure on the Greenback. This is driven, in part, by the fact that America's twin deficits are approaching 20% of GDP and the likelihood that while the rest of the world is moving toward actions the U.S. has already taken – *massive increases in fiscal spending* – on per capita basis, the U.S. has been, and is expected to remain, the most profligate among the global systemic economies. We are mindful, however, that the faintest prospect of higher short rates – even if *higher* is 18+ months from and +25 or +50 basis points above current levels – will entice investors to look more longingly on the Dollar. Any strengthening will put pressure on Emerging Markets operators, particularly those with debt denominated in dollars. The potential for this uptick in EM volatility to be more than fleeting is reason enough to trim our recommended exposure.

The perception of higher interest rates and what that portends for the Dollar also suggests some selling pressure on hard assets and commodities, particularly those used to hedge inflation fears. The suggestion being that the Fed, through words rather than deeds, has intimated that it is ready to fight back incipient inflation if it begins to run too far too fast. By "talking about talking about…" the Fed is attempting to dampen the volatility of inflation expectations and with it, inflation outright. We are suspicious of the efficacy of this approach. The Fed no doubt believes it will be ready and the Board (under the stewardship of its current chair) likely harbors every intention to act, when necessary. We are suspicious whether it will be so easy to do (given mounting debt loads), whether the timing will be so obvious, and whether the political winds will be blowing at their back to do so. In this scenario, we see a reasonable case that inflation will be less transitory than is roundly suggested. We interpret the Fed's language as acknowledging, without saying matter-of-factly, that inflation *may* be more structural than the market has discounted. Last year we introduced a modest allocation to Gold in our tactical allocation portfolios within an elevated-to-benchmark (6% vs. 2%) allocation to Cash. We recommended using 3% of our 6% Cash holding to establish a position in the yellow metal. While a modest adjustment, with this writing we are increasing our exposure to 4% Gold.

At a certain point, the Fed will likely have to taper its bond buying program. This would likely result in higher real yields and could put a headwind into the advance on inflation hedges in general. We do not believe that shift in policy is imminent. If crude oil continues to move toward $100, as we suspect, it is likely we're not out of the woods on ratcheting inflation expectations just yet.

Strategas Recommended Asset Allocation (Jun'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

Globally, the virus continues to ebb and flow at different rates and levels; respective national and local government responses are in no way universal. In the U.S., the comparative response of state government (i.e. gubernatorial) remains – *in our view* – exhaustingly partisan. More granularly, employers are clearly weighing the cost between prudence and urgency and the workforce, loosely defined as: *those gainfully employed; those who would like to be; those who could be, but remain hampered in their return by latent public health restrictions (i.e. school closures); and, those who could be, but prefer the generosity of the public purse (i.e. enhanced government unemployment benefits).* The nascent strength of this recovery should continue to intensify as we clear the virus and smooth out the associated dislocation associated with vaccinating ~7.5 billion people and re-opening a global economy mandated to a near subsistence crawl. Stay the course. Something is happening. The recovery is at an inflection point. NB

IMPORTANT DISCLOSURES

This communication was prepared by Strategas Asset Management, LLC ("we" or "us"). Recipients of this communication may not distribute it to others without our express prior consent. This communication is provided for informational purposes only and is not an offer, recommendation, or solicitation to buy or sell any security. This communication does not constitute, nor should it be regarded as, investment research or a research report or securities recommendation and it does not provide information reasonably sufficient upon which to base an investment decision. This is not a complete analysis of every material fact regarding any company, industry, or security. Additional analysis would be required to make an investment decision. This communication is not based on the investment objectives, strategies, goals, financial circumstances, needs or risk tolerance of any particular client and is not presented as suitable to any other particular client.

For investors subject to MiFID II (European Directive 2014/65/EU and related Delegated Directives): We classify the intended recipients of this communication as "professional clients" or "eligible counterparties" with the meaning of MiFID II and the rules of the U.K. Financial Conduct Authority. The contents of this report are not provided on an independent basis and are not "investment advice" or "personal recommendations" within the meaning of MiFID II and the rules of the U.K. Financial Conduct Authority.

The information in this communication has been obtained from sources we consider to be reliable, but we cannot guarantee its accuracy. The information is current only as of the date of this communication and we do not undertake to update or revise such information following such date. To the extent that any securities or their issuers are included in this communication, we do not undertake to provide any information about such securities or their issuers in the future. We do not follow, cover, or provide any fundamental or technical analyses, investment ratings, price targets, financial models or other guidance on any particular securities or companies. Further, to the extent that any securities or their issuers are included in this communication, each person responsible for the content included in this communication certifies that any views expressed with respect to such securities or their issuers accurately reflect his or her personal views about the same and that no part of his or her compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in this communication. This communication is provided on a "where is, as is" basis, and we expressly disclaim any liability for any losses or other consequences of any person's use of or reliance on the information contained in this communication.

Strategas Asset Management. LLC and Strategas Securities, LLC are affiliated with Robert W. Baird & Co. Incorporated ("Baird"), a broker-dealer and FINRA member firm, although the firms conduct separate and distinct businesses. A complete listing of all applicable disclosures pertaining to Baird with respect to any individual companies mentioned in this communication can be accessed at http://www.rwbaird.com/research-insights/research/coverage/third-party-research-disclosures.aspx. You can also call 1-800-792-2473 or write: Robert W. Baird & Co., PWM Research & Analytics, 777 E. Wisconsin Avenue, Milwaukee, WI 53202.