STRATEGAS
ASSET MANAGEMENT

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In this month's Insight, Nicholas Bohnsack discusses the four investing themes that have emerged in our industry-leading research so far in 2022.

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Four Macro Themes to Start 2022

The outlook among clients is decidedly more muted than it was just a few short months ago. Increasingly, it would seem, the relapsing-remitting nature of Covid appears to have disabused many investors of any hope the cyclical recovery can transition into a self-reinforcing expansion. Certainly not in the classical way. Though the economy continues to have some wind at its back – *Atlanta GDPNow is still holding at +5% Q/Q AR* – given the Fed is only just gearing-up to begin normalizing policy, despite the notable increase in and broadening of inflation, suggests equity returns will increasingly be correlated with long bonds as investors adjust to the shift in the economy's liquidity profile. Near-term we expect volatility to provide further discomfort.

Tactically we remain comfortable with the neutral, albeit pro-cyclical, positioning we established in our global allocation portfolios back in September — reducing exposure to Equities broadly and to the Technology (Neutral) and Communications (Underweight) sectors specifically appears to have been the right choice though it will take a notable break in the erstwhile FANG names to take the market materially lower given their share of the composite. We maintain Equity exposure at 62%, just a clip above the benchmark in our baseline portfolio (down from 67% in Sep'21). We continue to favor international shares to domestic issues and we are generally positive on emerging markets – particularly the commodity exporting countries – but have held back allocations given the outsized share of Chinese equities in many of the key access funds.

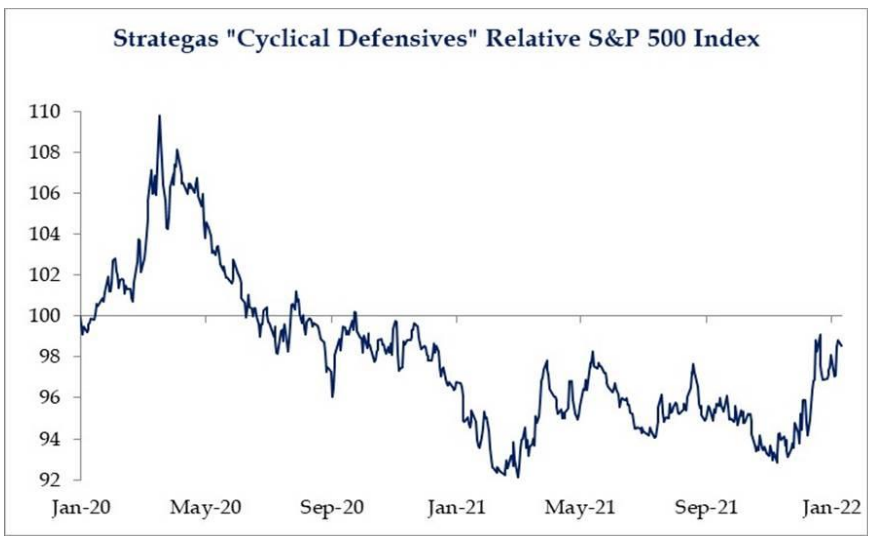
Economically, we appear at a crossroads; there is enough uncertainty about the durability of the recovery to wonder whether (or when) the market might begin to price in a late-CY'22 or early-CY'23 mid-cycle slowdown. We've grown increasingly suspicious with how long Consumer shares, particularly in the Discretionary sector, can live in harmony with Energy and Materials names. Outside Housing and Autos there has been little to love recently. While we believe market dynamics could limit long rates from breaking too far above 2% when rates go, they go; any sustained increase from current levels is likely to have an impact on all consumer segments, Housing and Autos included.

Growth names may have called forward a fair amount of demand during the pandemic. The outlook for net income growth for the FAAMG names is expected to be +7.7% Y/Y in CY'22, a full percentage point lower than the overall index. So, Value may be where the *growth* is. If global health concerns ebb and supply chain issues ease, the cyclical recovery could still find a way to transition into a self-reinforcing expansion, even if it's an expansion less robust than perhaps most hope for. In that vein, to the extent to which "quantitative easing" can be viewed a boon for financial and real assets, it has been a very difficult period for active management. The HFRI's

Long/Short Index has underperformed the S&P 500 for 13 consecutive years since 2009; the relative performance of actively managed large-cap funds has steadily declined over the same period. As our Chief Strategist Jason Trennert has highlighted, one potential reason for this is the artificially low cost of capital has allowed weak corporate players to stay alive. Generally speaking, financial analysts and portfolio managers are not trained to buy unprofitable companies – some even have an interest in shorting them. It can be argued that higher inflation will be a profits-tailwind for high-quality companies that can maintain pricing power, but it is also likely to depress the multiples investors are willing to pay for earnings. Enter active management.

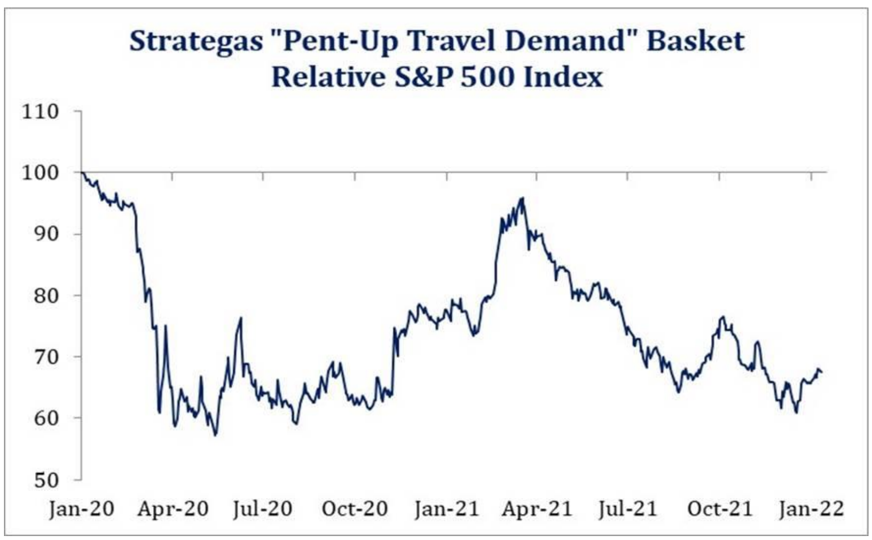
As we look through the first half of 2022, four macro investment themes have presented themselves in our research:

Cyclical Defensives – With equity markets rallying nearly +30% in 2021, growth rates exceeding historical norms, and less accommodative monetary policy expected in 2022, we felt it was appropriate to have an idea that is more defensive and yield oriented. While half of the stocks we believe carry the proper characteristics to constitute this theme are in traditional defensive sectors like Staples and Utilities, we also would leverage exposure to the more defensive areas of the cyclical sectors like Insurance, Railroads, Consulting Services, and Environmental & Facilities services. Our basket has a dividend yield of ~2.4%.

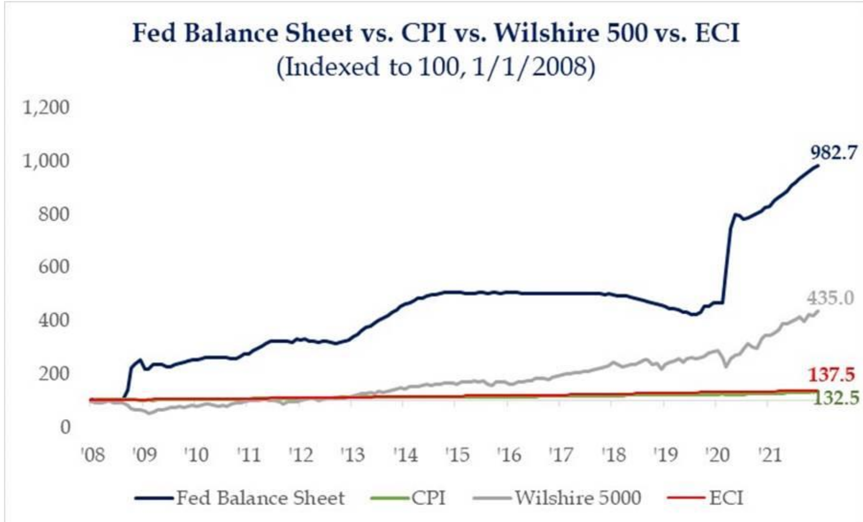


Inflation Likely to be Stickier – We have felt for some time the inflation we are seeing will be less transitory and more persistent. This view may be becoming increasingly consensus, but we continue to believe companies with pricing power – Energy, Materials, and REITs should benefit.

Another Round of "Re-Opening" for the Services Industry – Re-Opening in fits and starts has been a notable challenge for the economy, particularly when new variants emerge. However, we remain of the view that society has broadly adapted to a new normal that sadly includes living with Covid.



Quantitative Tightening – There would appear little doubt that both the Fed and other global central banks recognize the need to tighten monetary policy to address the potential for persistently high inflation. The question now is the pace and the manner in which such tightening will occur. Problematically, the Fed is still easing –according to the New York Fed's schedule, the central bank is poised to purchase another $40 billion in Treasury securities over the next four weeks. While our Chief Economist, Don Rissmiller and our Fixed Income Strategist, Tom Tzitzouris believe there will be four rate hikes in 2022 they believe that the Fed will be forced to employ quantitative tightening, a passive attempt to reduce the amount of assets on the Fed's balance sheet by allowing debt securities to mature.



Taken together and against the current backdrop, it would seem investors in general and equity concentrated investors in general, will be well-served by increasingly granularity in portfolio construction. We believe, given the broader Indexes and their component sectors remain largely market-cap dominated, that taking a thematic approach and understanding the cross-current of characteristics that bring a portfolio of stocks together to offer highly correlated exposure to those themes will emerge as an important source of alpha. NB

Strategas Recommended Asset Allocation (Jan'22)

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

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