STRATEGAS
ASSET MANAGEMENT

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In this month's Insight, Nicholas Bohnsack suggests that while we may be too cautious about taking the long view, in the absence of both an epidemiological solution and a discernable growth catalyst, we believe the recovery will take longer than the consensus currently expects.

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Navigating a Generational Moment

Consider that it was not all that long ago – February – that the market was breaking to the latest in a series of all-time highs, and the economy, while not overwhelmingly robust, was showing only the faintest signs of age. Perhaps more importantly, there was little evidence of the acute excesses that typically manifest in the top-heavy outcomes that ultimately lead to recession. This is not to suggest that the Long Cycle was set for perpetual expansion. Still, a good case could be made that the rolling block of persistently accommodative monetary policy paired with the semblance of a modest thaw in U.S.-Sino trade tensions and the concomitant improvement of economic conditions in the developing world, generational low levels of unemployment, and a tax-incented increase in capital spending domestically could conspire to keep the U.S. economy from going over the edge before 2021.

Earlier this year, we modestly reduced our recommended exposure to equities – to 64% from 68% – and increased cash believing the economy was entering a recession. At that point, we cast a small preference for value vs. growth and international shares vs. domestic.

How quickly things can change…

The onset of the crisis left us with greater exposure to equities than desired, though we acknowledge the repair the market's advance has offered. We have shifted our equity allocation in favor of growth and have reduced our exposure to international equities, leaving us with an above-benchmark allocation to domestic shares. Our U.S equity sector allocation sits on this scaffolding, with a modest tilt toward growth sectors – recommending overweight exposure to Tech & Communications – and an internal bias – overweight Health Care & Industrials.

But larger issues seem to be at play. Though this began with the rapid and global spread of a deadly coronavirus, Covid-19, it was the unprecedented decision to mandate billions of people to shelter in place to mitigate the spread and "flatten the curve," that had the

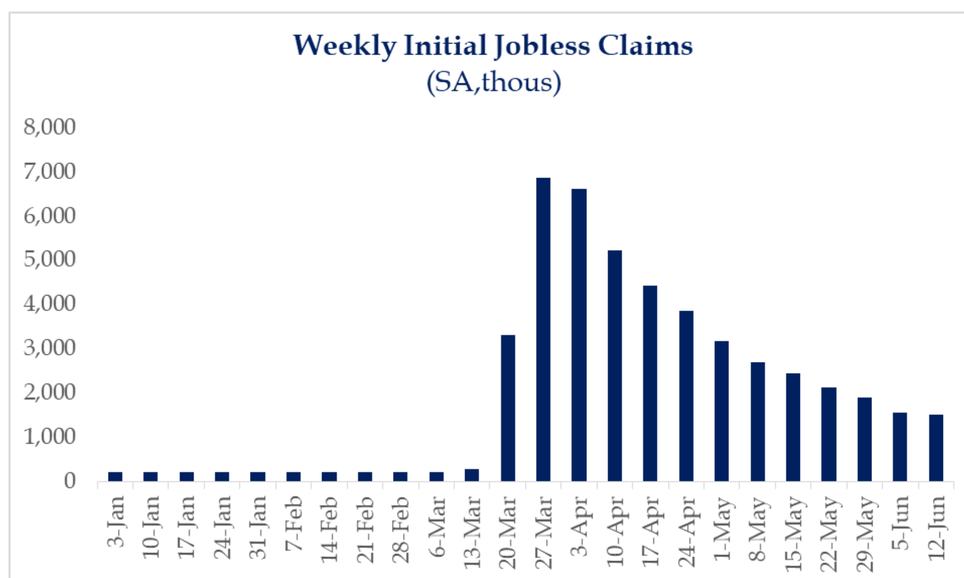
effect of both shocking the global economy to a near-subsistence crawl and creating the universal uncertainty against which we are not just reminded of the broad philosophical divisions existing in society – and (again) made witness to some of its uglier and altogether too frequently tragic manifestations – but are compelled to do something about it. This is a generational moment. The challenges inherent in making any discernable progress are daunting but worthwhile… regardless of your predisposition.

Investors are wise to focus their attention on what they're trying to solve. For some, the weightier societal issues are – or will become – the focus, but for most, their objectives will remain the same. Navigating the environment may prove more challenging.

While we have generally been (and remain) less optimistic than the consensus on just how quickly the broader economy will ultimately return to previous levels of activity, demand, and profitability, we have had a healthy respect for the rally in shares off their late March lows. Given the overwhelming application of monetary policy, it is not surprising that liquidity-driven momentum has been such a powerful price catalyst. Given this data, we have focused on the relationship between high and low Beta shares. An examination of previous beta-led rallies shows that: a) they are notorious for breaking from one extreme – high Beta oversold relative to low Beta – to the other – high Beta overbought relative to low Beta; and, b) after moving to an extreme overbought position will either fall into the arms of durable, fundamentally-supported leadership, or fall back into a consolidation phase until more discernable

directional evidence presents itself. This past week, high Beta shares broke to a +2 standard deviation extreme relative to low Beta shares. Investors appear convinced that recent signs of improvement off historically bad (i.e., Depression-comparable) activity levels should be extrapolated into a steep normalized forward demand curve.

As our Economics team has highlighted, while the health-related impact of the pandemic is clearly not over, there continues to be evidence of a durable bottom developing in global economic activity. While the timing of the bounce was uncertain, this should have been anticipated after such a severe plunge in business. The worst looking growth rates likely appear to be passing. At issue is whether the recent emergence of cyclical leadership will amount to anything more than a "v-shaped head fake" in the absence of a discernible growth catalyst. The second-quarter data will prove important in making, or refuting, the case.



Believers gravitate to the "transitory shock" narrative, extrapolating a flatter COVID curve and the marked improvement in non-farm payrolls into a series of smooth re-openings and the timely recovery to pre-pandemic levels of output and profitability. Skeptics highlight the absence of both a therapeutic to treat the infected and a vaccine to inoculate the rest of us, which, in turn, is translated into a broad behavioral accommodation that is severely dampening commercial appetites and rendering the dislocation and structural damage to the economy more permanent.

These competing tensions have framed many of our recent conversations with clients. For our part, we harbor concern for overly optimistic forecasts of normalized forward demand with 20+ million people continuing to receive unemployment benefits and the number of permanent job losses continuing to increase. Too bearish? Perhaps. Many market observers have highlighted the broadening participation of stocks in the current rally – 95% of S&P 500 constituents above their 50-day M.A. – and the recent (modest) outperformance of value as the starting blocks for a substantive rotation. While we are generally not disposed to such caution on the prospects for U.S. economic growth, we are mindful that the calculus of data construction will present (what appears to be) significant improvement with even a partial re-opening. While we may be too cautious about taking the long view, in the absence of both an epidemiological solution and a discernable growth catalyst, we believe the recovery will take longer than the consensus currently expects.

Strategas Recommended Asset Allocation (Jun'20)

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

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