Market Strategy
by STRATEGAS A BAIRD COMPANY

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Market Strategy Weekly

June 4, 2021

This week, Strategas CEO Jason Trennert takes stock of an unusual market environment, answering our questions on inflation concerns, the Federal Reserve, where we are in the market cycle (and how to play it), and recent market frothiness.

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INFLATION HOTTER | STILL EARLY CYCLE | MEME STOCK MANIA

Recent inflation numbers came in higher than expected—how does this affect Strategas' view on inflation, and what does it mean for the Fed? There's no question that the recent inflation numbers have come in a little hot, but the Fed has been consistent in thinking this is largely the result of the economic shutdown and re-opening and that it will be transitory. The Fed has made its bed and must sleep in it, which is to say, they are focused on employment and getting back to pre-Covid numbers. Whether inflation is transitory will have a lot to do with fiscal policy coming out of Congress. If the policies are constructive—if they lead to stronger profits, higher wages, higher productivity—there's a decent chance that this is transitory. If the spending doesn't lead to productivity and the Fed stays easy, that could be trouble. There's no question that you're going to get higher inflation over the next six months; whether it becomes transitory or not really depends on Washington.

It's been quite a run for the stock market—where do you think we are in the cycle and how do you position for this environment? There are some signs of speculation out there, but by-and-large, our "bull market top checklist" tells us that we still have time. We've been doing the checklist for twenty years—it's nine things we look at to give an indication of when things are getting too frothy. Right now we can only check off two, and that's good. We also feel that we're in the early part of the cycle, largely due to how strong earnings are and how easy Fed policy is. We think the best way to play this is through early-cycle sectors: Financials, Energy, Basic Materials, Industrials. Technology is tougher—it's the most cyclical sector, but there's a valuation issue there. So we would stick more towards the high quality tech names that are generating cashflow in the near term, as opposed to high flyers where most of the value is way out in the future.

Is the unwinding in some of the speculative corners of the market good for the overall sustainability of the bull market? Not to wish losses on anyone, but I think it's good that some of the solar stocks, meme stocks, Bitcoin, etc. have seen a little air come out because it means there's some rationality in the market. Plus, given how strong the economy and earnings are, there are a lot of choices for your money—you really don't have to go gambling. You can get high quality companies with strong growth rates at reasonable prices. And so to me, it bodes well for sustainability of the bull market. There's an awful lot of money out there, though, so it's understandable that some of that liquidity finds its way into riskier assets. And with money growth still ~18% year over year, we don't think this is over. You'll see meme stocks as we go along but there's plenty of strength in the real economy, and it doesn't appear as if any of these frothy areas are large enough to be systemically problematic.

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