APRIL 2021 | ISSUE NO. 9

FROM THE DESK OF ERIK OROS

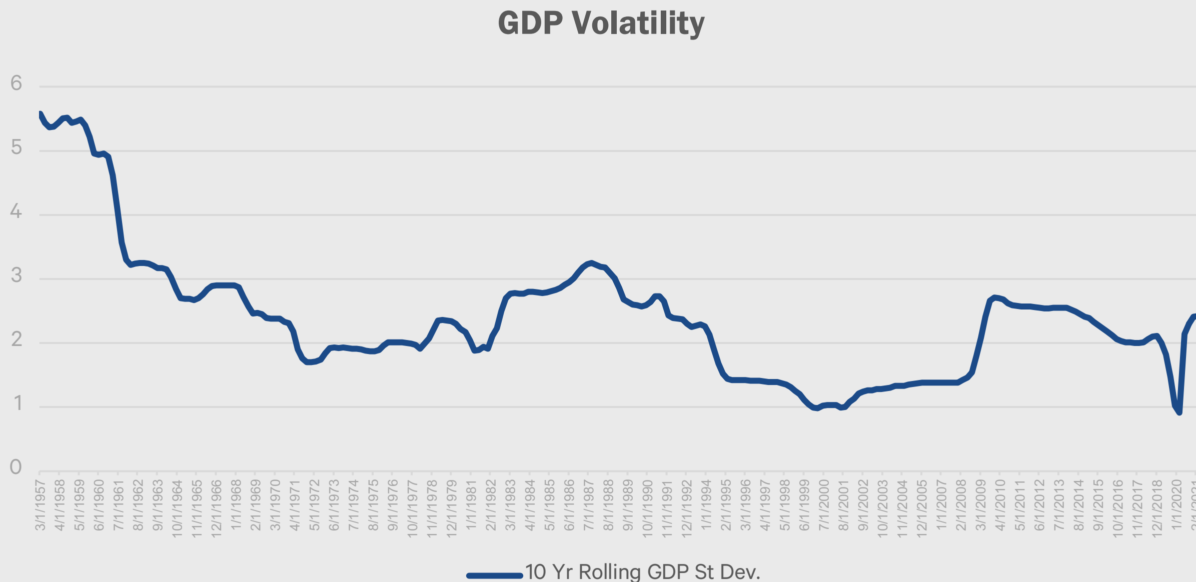
In the coming weeks, much of the East Coast and Midwest will be visited by Brood X, tens of billions of cicadas that hatch at once every 17 years, like clockwork. For just six weeks, the swarm will emerge to engage in a mating ritual, causing no shortage of commotion, belting out their cry at decibels that compare to a 737 takeoff.

Just as such residents will be reminded of this periodic, and easily forgotten certainty, investors have been awoken to the specter of inflation, and cyclicality absent from global economies for decades. The fervor for this prospect has reached in many ways a fever pitch over the past month. The question of whether these factors will burrow away for another 17 years remains to be seen.

Over the past few letters, we have debated the question of inflation and bond yields, their corollaries and market effect, and the competing arguments around their persistence. Both Secretary Yellen and Chair Powell have assured us that inflation is likely to be temporary and mitigated by well-entrenched disinflationary factors such as technology, aging, and globalization. Although, we would be remiss not to mention a notable change in forward guidance as inflationary factors have continued to entrench. Supply chains, especially in the industrial complex where supply is least elastic, have become increasingly stressed. Ultimately, the path of such factors beyond the short term remains highly uncertain. However, we remind investors of the folly in the thesis that "this time is different."

In fact, it is the cyclical nature of the global economy, much suppressed by central banks' fear of doing too little, that is by nature the essence of how economies function. Supply and demand imbalances clear through this mechanism, and without shocks and persistent intervention global economies have been able to smooth such cycles and minimize disruption. Unfortunately, the globe has been affected by one of the most severe demand and supply side shocks since World War II

as a result of the global pandemic. Bottlenecks in semiconductors and container ships are just the latest examples of what is likely to be a strained industrial complex as demand surges due to reopening and continued fiscal support for consumption.



In detail, we have laid out the case for a shift towards more cyclical, inflation-leveraged exposure in portfolios. Violent rotation however is likely to remain in force for markets as growth sectors and those most exposed to duration risk have corrected to levels where opportunity amongst the carnage has emerged. Across both value and growth, expectations for the duration of the cyclical recovery have begun to moderate. Perhaps a harbinger for the months ahead, despite earnings reports that exceeded expectations by an unprecedented degree, each of the Big 6 tech companies, now trades lower than their preprint levels. Fears around durability of this short-lived cycle remain omnipresent.

The notion of efficient markets is one that has thrived in an environment absent of shocks and where interest rates have allowed valuations for both equity and fixed-income to expand to levels not seen since the dot-com era. Continued lower rates and absence of cyclicality is an environment we believe investors should not count on in the coming quarters. Both monetary and fiscal policies have the potential to be highly disruptive. A tightening even in the form of forward guidance perhaps combined with the possibility of meaningfully higher tax rates seem to be questions of when, not if. Valuation is a poor short-term indicator, but over the medium to long term is highly predictive of expected returns. Investors are likely to find that the passive 60/40 index allocations that trounced more tactical management over the past decade, are likely to be challenged.

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