# FED ON THE MARGIN

As we noted after the Georgia runoff elections for Senate,

"Importantly, the pro-growth tax, regulatory and trade policy backstop that has been underneath equity markets since 2016 is now gone. We are no longer in a domestic policy bull market. If the Federal Reserve starts making comments about tightening or scaling back asset purchases, stocks could reprice downward to the new policy reality very quickly."

This week we get our first look at Fed Chairman Powell in the context of potential monetary policy tightening. The Fed has been max accommodative since the depths of the COVID-19 panic in March 2020. While no policy changes are likely as the Fed convenes this week, we will get an update from Powell on how the Fed sees the outlook for the economy in the wake of new fiscal "stimulus" and the vaccine roll-out. A more positive economic assessment could bring forward expectations of QE tapering and eventual rate hikes.

Last week four of the Fed's eighteen policymakers said they were open to debate on reducing Fed bond buying by the end of 2021. Other Fed members, including Vice Chairman Clarida, have gone on record recently saying such discussion is premature and current monetary accommodation should remain until 2022.

This is the most important monetary policy debate at the Fed for this year and years to come. The "back to normal" crowd at the Fed sees vaccines and government spending creating an economic recovery that brings things back to a more pre-pandemic "normal." In sharp contrast, the prolonged recession crowd at the Fed sees a slow, plodding recovery with a seriously scarred labor force.

Thus far, Powell has committed to effectively monetizing any and all government "stimulus" spending. When he changes his tune, "risk-on" asset prices are likely to correct. Without a backstop of pro-growth fiscal and regulatory policies, a repeat of the 2013 "taper tantrum" is possible. The phrase, taper tantrum, describes the 2013 surge in Treasury bond yields, resulting from the Fed's announcement of future tapering of its policy of quantitative easing. Powell has sought to alleviate any fears of a 2013 repeat that saw financial conditions tighten dramatically. Investors expect him to reaffirm that message this week. It will be a big surprise if he does not.

# ALLOCATOR

## Fixed Income

Bonds are an asset class that does well in a deflationary policy environment (Low Growth & Strong Currency)

We have long said the Treasury bond bubble will pop again as it did from May 2013-Jan 2014 when long term Treasury bonds fell 18%. Treasury bond prices are at risk to fall 30-50%, and we expect any moves higher in bond prices (lower in yields) to be short-lived. Since most other bonds price off of Treasury yields, fixed income in general is a risky asset class. Bonds are not automatically low risk.

| Asset | ETF | Action Date Red Sell/Green Buy | | Current Price | % Gain/Loss | Policy Notes |
|---|---|---|---|---|---|---|
| Investment Grade | LQD | 9/9/2016 | $119.00 | $135.70 | 14.0% | |
| Aggregate Bond | AGG | 9/9/2016 | $109.00 | $117.25 | 7.6% | |
| Municipal | MUB | 9/9/2016 | $111.00 | $117.09 | 5.5% | |
| TIPS | TIP | 9/9/2016 | $114.00 | $127.77 | 12.1% | |
| Extended Duration | EDV | 9/9/2016 | $128.00 | $144.75 | 13.1% | |
| US Treasury 3-7 yr | IEI | 9/9/2016 | $124.00 | $132.55 | 6.9% | |
| US Treasury 7-10 yr | IEF | 9/9/2016 | $109.00 | $118.58 | 8.8% | |
| US Treasury 20+ yr | TLT | 9/9/2016 | $133.00 | $151.88 | 14.2% | |
| International Total Bond | BNDX | 9/9/2016 | $54.40 | $58.22 | 7.0% | |
| High Yield | HYG | 4/12/2016 | $77.00 | $87.30 | 13.4% | Act more like equities than bonds, benefit from improving growth |

## ALLOCATOR

### Commodities

A change in the price of gold is a change in the value of the currency. When gold rises, the currency's value falls and vice versa. Commodities are an asset class that does well when the currency is weak. If growth is slowing while the currency weakens, there is stagflation - own precious metals. If growth is accelerating while the currency weakens, there is an inflationary expansion - own agriculture, industrial and energy commodities.

Gold's 2020 rise has been driven by a general "risk-off" stance caused in large part by fear about coronavirus' impact on economic shutdowns coupled with rising odds that an anti-growth policy mandate would result from Election 2020. We expect these fears to be transitory as the economy continues to "open." Progress on coronavirus treatments and vaccines suggest decreased odds of further economy wide shutdowns. With the Senate runoff complete, Democrats have a policy mandate for at least the next two years.

| Asset | ETF | Action Date Red Sell/Green Buy | | Current Price | % Gain/Loss | Policy Notes |
|---|---|---|---|---|---|---|
| Gold | GLD | 9/21/2020 | $179.52 | $173.90 | -3.1% | |
| Silver | SLV | 9/21/2020 | $23.03 | $23.66 | 2.7% | |
| Energy | DBE | 8/13/2014 | $28.97 | $11.46 | -60.4% | |
| Oil | USO | 7/30/2014 | $37.00 | $35.23 | -4.8% | |
| Agriculture | DBA | 9/13/2011 | $32.50 | $16.21 | -50.1% | |
| Broad Comm. Index | GSG | 8/5/2011 | $33.00 | $12.77 | -61.3% | |
| Base Metals | DBB | 6/17/2011 | $23.00 | $17.36 | -24.5% | |

# ALLOCATOR

## Real Estate

Real Estate is an asset class that performs well when growth is accelerating. When rising growth is coupled with a strong currency, own real estate tied to business activity (like commercial REITS). When rising growth is coupled with a weak currency, own real estate tied to commodities (farmland).

Commercial RE will be helped by improving real economic growth and continued movement to an "open" economy after broad shutdowns in the first half of 2020. RE properties leveraged to businesses & economic growth are preferred under pro-growth US policies.

| Asset | ETF | Action Date Red Sell/Green Buy | | Current Price | % Gain/ Loss | Policy Notes |
|---|---|---|---|---|---|---|
| REIT | VNQ | 9/21/2020 | $77.75 | $85.77 | 10.3% | |
| Residential | REZ | 12/21/2016 | $61.00 | $68.45 | 12.2% | |
| Building/Construction | ITB | 12/21/2016 | $28.00 | $62.00 | 121.4% | |
| Mortgage REIT | REM | 4/1/2016 | $35.00 | $32.48 | -7.2% | |

## ALLOCATOR

### US Equity

An 1980s/90s type of policy driven equity bull market is the ultimate goal. The 2014 midterm House/Senate/ gubernatorial shifts put us on that path, as pro-growth candidates propelled the GOP to majorities. It was a repudiation of anti-growth economic policies and a big step toward a Reagan/Clinton type of equity bull market. Despite the voters' growth signal, Obama doubled down on his tax/spend/regulatory (EPA) agendas in 2015 causing stocks to be range bound and volatile. As 2016 began, policy uncertainty ahead of November's elections became the biggest threat to equities. The ebb and flow of the presidential political season moved markets in both directions as investors waited to learn which policy theme would prevail that November – growth vs. redistribution. Voters decisively made their choice. Growth won Election 2020, unleashing a U.S. equity bull market. Trump's pro-growth policy agenda beat Hillary's anti-growth policy agenda in landslide fashion. Republicans retained control of the Senate, House and increased their control of governorships by three. Election 2020 halted pro-growth policies. It remains to be seen how far Biden, with Party control of the House and Senate, will push a dramatic tax and spend policy agenda.

### US Equity - Cap Size

| Asset | ETF | Action Date Red Sell/Green Buy | | Current Price | % Gain/Loss | Policy Notes |
|---|---|---|---|---|---|---|
| Micro | IWC | 7/11/2016 | $72.00 | $135.45 | 88.1% | |
| Total Market | IWV | 5/19/2016 | $117.00 | $230.66 | 97.1% | |
| Large | IWB | 5/19/2016 | $111.00 | $217.62 | 96.1% | |
| Small Cap | IJR | 5/19/2016 | $54.00 | $101.16 | 87.3% | |
| Mid Cap | IWR | 4/6/2016 | $38.57 | $71.28 | 84.8% | |

# POLICY BASED INVESTING

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## US Equity - Style

| Asset | ETF | Action Date Red Sell/Green Buy | | Current Price | % Gain/Loss | Policy Notes |
|---|---|---|---|---|---|---|
| Large Growth | IWF | 7/11/2016 | $101.00 | $247.58 | 145.1% | |
| Small Growth | IWO | 7/11/2016 | $140.00 | $316.21 | 125.9% | |
| Small Value | IWN | 5/19/2016 | $99.08 | $143.79 | 45.1% | |
| Mid Growth | IWP | 5/9/2016 | $90.00 | $106.77 | 18.6% | |
| Large Value | IWD | 4/6/2016 | $95.00 | $140.27 | 47.7% | |
| Mid Value | IWS | 4/6/2016 | $68.00 | $100.70 | 48.1% | |

## US Equity - Sector

| Asset | ETF | Action Date Red Sell/Green Buy | | Current Price | % Gain/Loss | Policy Notes |
|---|---|---|---|---|---|---|
| Staples | XLP | 6/5/2017 | $57.00 | $65.07 | 14.2% | |
| Utilities | XLU | 6/5/2017 | $54.00 | $62.84 | 16.4% | |
| Metals/Mining | XME | 5/8/2017 | $29.00 | $34.50 | 19.0% | |
| Energy | XLE | 3/13/2017 | $69.00 | $42.07 | -39.0% | |
| Healthcare | XLV | 2/8/2017 | $71.00 | $117.59 | 65.6% | |
| Discretionary | XLY | 11/14/2016 | $79.00 | $170.10 | 115.3% | |
| Financial | XLF | 7/18/2016 | $19.00 | $30.34 | 59.7% | |
| Materials | XLB | 4/6/2016 | $44.00 | $74.38 | 69.0% | |
| Industrial | XLI | 3/14/2016 | $52.00 | $88.51 | 70.2% | |
| Technology | XLK | 3/7/2016 | $41.00 | $132.83 | 224.0% | |

## Foreign Equity

| Country | ETF | Action Date Red Sell/Green Buy | | Current Price | % Gain/Loss | Policy Notes |
|---|---|---|---|---|---|---|
| World Ex US | VEU | 11/15/2016 | $51.71 | $61.00 | 17.97% | |
| Canada | EWC | 10/1/2018 | $27.21 | $31.64 | 16.28% | |
| Mexico | EWW | 10/1/2018 | $32.69 | $42.96 | 31.42% | |
| China | FXI | 8/5/2019 | $39.86 | $51.71 | 29.73% | |
| Hong Kong | EWH | 7/6/2016 | $24.08 | $26.05 | 8.18% | |
| Denmark | EDEN | 7/2/2018 | $63.89 | $98.93 | 54.84% | |
| Switzerland | EWL | 7/2/2018 | $32.58 | $45.69 | 40.24% | |
| Netherlands | EWN | 7/2/2018 | $30.51 | $44.29 | 45.17% | |
| Sweden | EWD | 7/2/2018 | $30.51 | $42.14 | 38.12% | |
| Eurozone | EZU | 7/2/2018 | $41.01 | $44.87 | 9.41% | |
| Spain | EWP | 7/2/2018 | $30.35 | $27.11 | -10.68% | |
| Poland | EPOL | 7/2/2018 | $21.78 | $19.15 | -12.08% | |
| France | EWQ | 7/2/2018 | $30.52 | $33.48 | 9.70% | |
| Germany | EWG | 7/2/2018 | $29.98 | $32.55 | 8.57% | |
| Italy | EWI | 7/2/2018 | $28.89 | $29.29 | 1.38% | |
| Austria | EWO | 7/2/2018 | $22.65 | $21.59 | -4.68% | |
| Israel | EIS | 2/26/2018 | $52.41 | $66.66 | 27.19% | |
| Vietnam | VNM | 10/9/2017 | $14.99 | $18.35 | 22.41% | |
| Indonesia | EIDO | 7/24/2017 | $26.78 | $24.41 | -8.85% | |
| Ireland | EIRL | 1/26/2017 | $39.00 | $50.77 | 30.18% | |
| Singapore | EWS | 1/11/2017 | $21.00 | $22.39 | 6.62% | |
| Norway | ENOR | 8/20/2016 | $20.00 | $26.18 | 30.90% | |
| UK | EWU | 8/4/2016 | $30.50 | $30.62 | 0.39% | |

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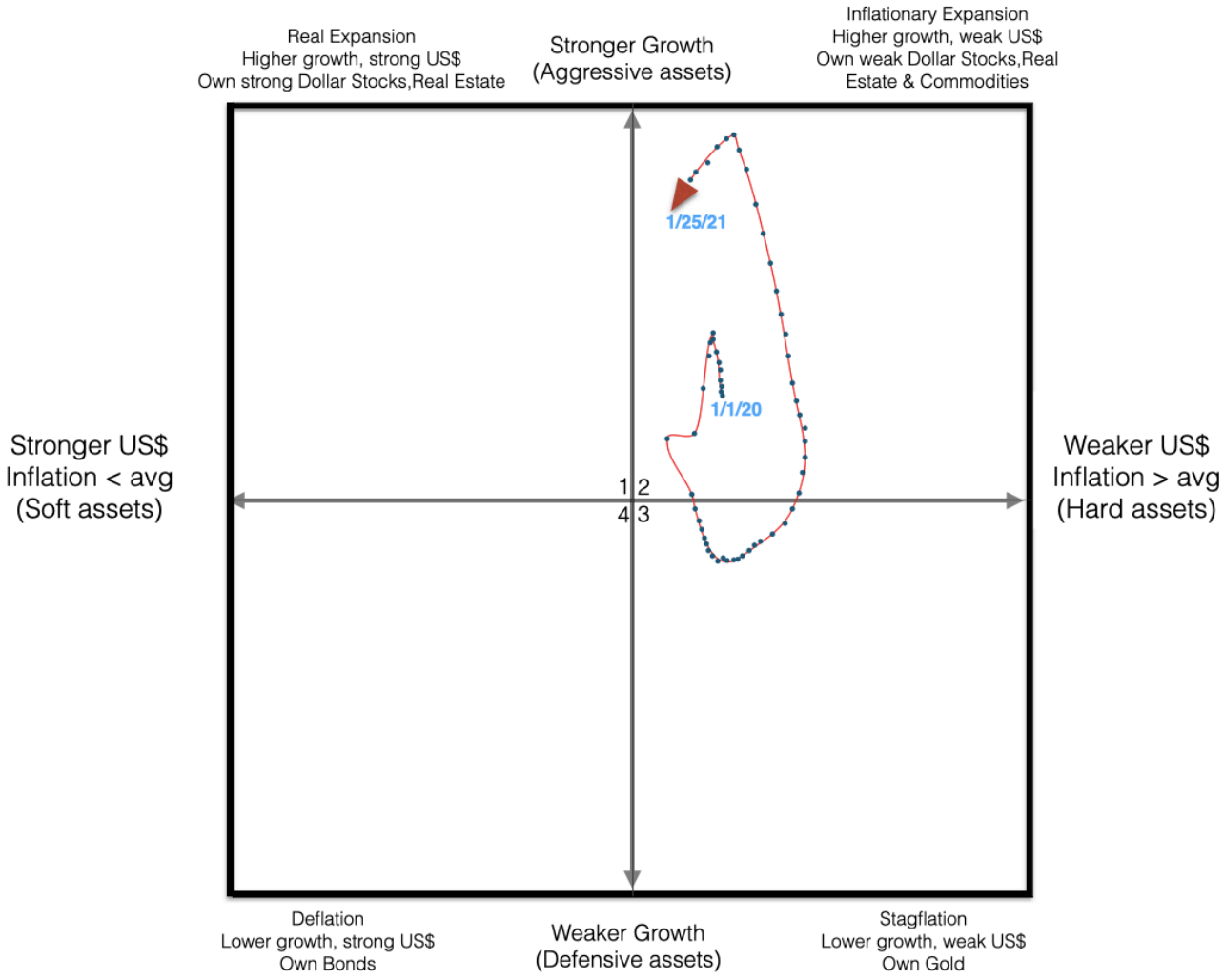
|---|---|---|---|---|---|---|
| Finland | EFNL | 7/26/2016 | $33.00 | $46.33 | 40.39% | |
| Japan | EWJ | 7/15/2016 | $47.00 | $69.24 | 47.32% | |
| South Korea | EWY | 7/13/2016 | $52.00 | $93.82 | 80.42% | |
| Hong Kong | EWH | 7/6/2016 | $19.00 | $26.05 | 37.11% | |
| Peru | EPU | 6/29/2016 | $30.50 | $35.26 | 15.61% | |
| South Africa | EZA | 6/29/2016 | $51.00 | $45.24 | -11.29% | |
| India | EPI | 6/27/2016 | $19.00 | $30.05 | 58.16% | |
| Taiwan | EWT | 6/21/2016 | $27.00 | $58.48 | 116.59% | |
| Thailand | THD | 5/20/2016 | $64.00 | $79.53 | 24.27% | |
| Belgium | EWK | 3/16/2016 | $16.50 | $20.07 | 21.64% | |
| New Zealand | ENZL | 3/5/2016 | $36.00 | $68.85 | 91.25% | |
| Philippines | EPHE | 8/5/2015 | $37.00 | $31.95 | -13.65% | |
| Qatar | QAT | 12/1/2014 | $24.00 | $18.94 | -21.08% | |
| Malysia | EWM | 10/3/2014 | $41.00 | $27.99 | -31.73% | |
| Australia | EWA | 9/16/2014 | $22.50 | $24.87 | 10.53% | |
| Greece | GREK | 7/14/2014 | $20.00 | $24.44 | 22.20% | |
| Portugal | PGAL | 6/4/2014 | $15.00 | $11.23 | -25.13% | |
| Columbia | ICOL | 6/27/2013 | $21.00 | $10.93 | -47.95% | |
| Turkey | TUR | 6/1/2013 | $58.00 | $27.99 | -51.74% | |
| UAE | UAE | 5/20/2013 | $23.00 | $13.14 | -42.89% | |
| Russia | RSX | 8/7/2011 | $30.00 | $19.97 | -33.43% | |
| Brazil | EWZ | 7/14/2011 | $60.00 | $35.04 | -41.60% | |
| Chile | ECH | 3/1/2011 | $61.00 | $31.61 | -48.18% | |
| Egypt | EGPT | 2/23/2004 | $64.00 | $26.75 | -58.20% | |

## POLICY MAP

Growth decreased versus last week (4.95 to 4.83) : Growth expectations are at risk from the Democrat sweep in Election 2020. With control of the House and Senate, Democrat policymakers are likely to attempt and achieve higher taxes on work, savings and investment. The Fed continues providing unlimited liquidity to prevent a solvency crisis after the first intentional recession in history.

Value of US$ strengthened versus last week (0.95 to 0.87): U.S. Dollar weakness could result from Democrats taking control of all three policy making levers.



# POLICY BASED INVESTING

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## BOND YIELD COMPONENT ANALYSIS

**Nominal Yield: 1.10% (+0%)** **Inflation Expectation Component: 2.09% (+1%)** **Real Growth Component: -0.99% (-1%)**

The ideal bond component pattern is flat or falling inflation expectations coupled with rising real growth expectations. The opposite has been happening since 2019. Zooming in on the yellow shaded area in 2020, you observe how real growth stopped falling and inflation stopped rising after the panic of COVID shutdowns ended. A welcomed rise in real growth expectations coupled with flat inflation expectations gave hope that credit markets were beginning to see past the dismal future bond investors had been positioning for all year. Since late November, that anti-growth respite has reversed. Real growth expectations are again crashing while inflation expectations are breaking up to new highs.